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Foreword

This book is the result of more than 12 years of professional experience in a large German bank, where I often worked with the management of international companies as a business consultant. The time period of this experience included the boom and crash at the beginning of the new millennium and the financial crisis. These practical impressions led to the conviction that there is a problem with ethics in the economy and that the lack of ethics is not only harmful to people but also leads to serious productivity losses. As a result, I have held seminars on business ethics in the bachelor's and master's degree at the University of Applied Science HTW in Saarbrücken. This teaching experience was incorporated into this book as well as an extensive literature study.

I would like to thank Ms. Danica Webb (USA) for the translation of the major part of this book.

Saarbrücken, Germany
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Christian A. Conrad

Introduction

The question of whether or not there is a need for ethics in business is still a scientific discussion. However, in the context of the 2000 Enron crisis, the first doubts arose as to whether a business enterprise without morality could work. Since the financial crisis that began in 2007, the economy and business administrations are increasingly confronted with the demand for more social responsibility. A common feature of the crises was the immoral enrichment efforts of managers at the expense of their companies and the system, and thus society. The market economy system places the individual at the forefront of economic value creation and grants him a great freedom of development. The pursuit of self-interest is intended to ensure the greatest possible motivation for the individual, and thus a maximum result for the general public seems to work less and less.

The central question to be answered in this textbook is the extent to which moral values play a role as productive forces for the economy. Our underlying method is a scientific approach. In this case, no normative approach is deliberately pursued and a morality is not demanded a priori by the economy. This morality would have to be subjectively and culturally relativized and could therefore claim no universality. Moral values in themselves, such as the dignity of man, should not be regarded as a requirement profile without logical reasoning, although they have a high target priority. Normative, moral, perhaps even emotional-related goals such as justice should be mentioned, but should not be used for argumentation when they are not productivity-enhancing. The aim is the optimal development of the productive forces in companies and national economy, i.e., the simple increase in welfare through output maximization while taking into account the welfare of all parties involved. A system of ethics founded purely on logic will be devised, one which stimulates the productive forces of the market economy. The aim is to reveal the ethics implied by the market economy, an ethics that can also claim international validity for the globalized economy. We hope to justify and promote ethics objectively and thus convincingly.

The term "business ethics" encompasses, according to the international standard, the ethics of companies in the business sector (meso level, corporate ethics, organizational ethics), managerial ethics in companies (micro level, personal ethics), and even ethics within the national economic framework (systemic level, economic ethics). The goal is to create a textbook for business ethics from the many ethical approaches and partly also from different conceptual uses. The aim is to show how ethics improves productivity in the economy. For practical application, specific ethics tools are provided.

In order to work out how people behave ethically and unethically and how this affects the economy, this book refers to newer research results from behavioral economics, but also from other disciplines such as psychology and sociology, thus leading to new conclusions for business ethics. The knowledge relevant to the students is first derived scientifically, and then the results are presented as summarized. After the ethical assessment approaches have been explained, the students are given an ethical assessment of economic behavior using case studies. Role-playing and games are also used to explain the behavior of people in relation to ethics.

The book begins with the foundations of business ethics by defining terms and delineating objectives. The importance of ethics for business, the economy, and the society is also discussed here. Then the ethical evaluation approaches are presented, which are intended to enable the reader to evaluate economic behavior ethically. Man in business is the next chapter. Here we will deal with man and his behavior. What motivates him? To what extent is it ethically oriented? Is there a sense of justice? Next, we will discuss the rules of the market. Does the market economy promote ethical behavior or is there a conflict of goals between ethics and market economy? Do companies have a social responsibility? We note that the answers to these questions are very much dependent on the legal framework of economic activity. In an economic anarchy, ethical behavior cannot be expected either by the companies or by the individual actors, which is why we turn to ethics as an ordinance. Here, the state as an actor has an important role to play. After analyzing the importance of ethics for productivity in the enterprise and in the economy, we present so-called ethics tools as the instruments with which the management can promote ethical behavior in their employees. The book concludes with an outlook and recommendations on business ethics as a discipline as part of economic education.

Contents

About the Author

Prof. Dr. Christian A. Conrad teaches economics and business ethics at Saarland University of Applied Science HTW. He published several books and papers about ethics, business, economics and financial markets. He was previously Senior Key Account Manager in the national and international corporate department of a major German bank.

Chapter 1
Basic of Ethics

What Follows Why?
In addition to your business and economic courses, this chapter will provide you with the concepts and the starting point of the applied discipline of business ethics.

Learning Goals
Students should be able to describe the basics of business ethics in their own words.

1.1 Basic Terms

Business ethics investigates the connections between ethics and economy, or to put it more simply, moral behavior in the economy and in particular the importance of moral behavior for the economy. Under the term "economy" we understand the system that produces goods and services to fullfil the needs of a society. Do economy and ethics go together at all? Is it possible to measure economic contexts with criteria such as good and evil? At first glance this seems unrealistic. Economy is something abstract, subject to its own laws. How can one differentiate between good and evil? Many people have tried to answer the last question, without having been able to develop a universally applicable definition of good and evil. The differentiation and designation of good and evil is greatly dependent on one's point of view, but one can speak to general tendencies. We almost always use good and evil in relation to the effect on a third party. An action is good if it is advantageous for others, and bad if it is harmful. It is impossible to reach a differentiation without addressing the relationship to an advantage or benefit. Societal norms and values are created in a process of trial and error, or cultural evolution. They express the behavior a society desires because it is advantageous for the society and its members. Behavior considered by the society to be positive is rewarded with social approval. On the other hand, negative behavior damaging to a society is punished through social exclusion or through the justice system as societal institutions. We say people

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are good if they bring benefit to other people and evil if they are harmful. The categorical imperative from the famous philosopher Immanuel Kant will be discussed later in detail as an example that expresses the same idea; act in such a way that your behavior could be the basis for a universal law. One could also follow the golden rule; do unto others, as you would have them do unto you. This we would consider moral behavior.

We can transfer this idea to the economy. Economics is a relatively abstract concept due to its complexity, yet the institutions and organizations were created by humans, for humans. An ethics of economics is thus legitimate if it asks whether the people acting economically and/or the institutions and organizations are good because they are good for the community. An ethics of economics can thus be reduced to the question of what economic actions, or the economy as a whole or in part, offers the society. Ethics in economics thus places people above the economy, and assumes that the economy should serve the people.

Moral or ethical is therefore to be defined in the following book as a human behavior that does not harm other people (living beings) objectively, and that their welfare is not diminished (definition).

It is conceivable that the agent did not intend this effect, that is, his mind was not moral. We also do not exclude that the action was objectively beneficial for the other person, but he does not care. For example, it would certainly be wrong to say that to give someone €100 is not moral only because he is a millionaire. Active action is not a prerequisite for unethical behavior. Inaction can be considered unethical, for example, if one does not help someone in an emergency situation.

Because we need an objective assessment criterion, our definition of moral differs from the common use of "moral" as the subjective viewpoint of society. Our definition of moral therefore also differs as an adjective from the corresponding noun "morality".

The word "morality" comes from the Latin: the custom (Lat: mos, mores custom, customs). According to this, morality depends on the time, that is to say, it is subject to fluid societal trends, as well as dependent on the particular culture, that is, from country to country. The applicable law covers only a part of these standards.

Norms are social behavioral guidelines (definition).

For instance: Do not smoke if others are eating. Respect the property of others, etc. The elementary norms are incorporated into the laws of a society.

Empirical studies show that apart from the damage caused by an action, the social norms, or the ethical consensus, are decisive for whether a person behaves ethically or unethically.[1]

For sociology, norms are the unwritten rules that make the conflict-free coexistence of many people in a society possible. Unclear or missing norms lead to anomie-producing situations, meaning a lack of social integration. Too much or too restrictive of norms cause special stress situations and contradictory norms create norm conflicts. If a society has many different groups or sub-societies (pluralistic

[1] See Singhapakdi, A./Vitell, S. J./Kraft, K. L. (1996); Frey, B. F. (2000) and Butterfield, K. D./Treviño, L. K./Weaver, G. R. (2000).

society), it will also have many different and conflicting norms, as each sub-society has its own norms. If a person moves in different sub-groups he must inevitably violate the behavior norms of the sub-groups. This applies not only to immigration but also between generations. A youth must behave according to the rules of his age group in order to be recognized there, but he is also dependent on the acceptance of his parents. And there are other norms of behavior. In contrast to norms, conventions are voluntary agreements between people, for instance the terms for objects in a language, or shaking hands with greetings.

What is ethics? The Roman Cicero (born January 3, 106 BC in Arpinum, † December 7, 43 BC at Formiae) translated the Greek term êthikê (ethics) with philosophia moralis. Thus ethics is the philosophy of morality.[2] Ethics (from the ancient Greek "ta ethika", translated as the moral doctrine) is then the science of morality, whereby the goal of this science as part of philosophy (the friend of wisdom) is to regulate the world and in particular the behavior of man. To investigate what includes not only the being of man, but how he should be in the world. For us, ethics answers the question of how we should behave properly. It is also called practical philosophy. So, ultimately, it is no more and no less than the meaning of life and the meaning of our existence as human beings. We want to understand ethics as the science of the analysis and assessment of human behavior with effects on third parties or all living beings.

Ethics can be described as descriptive, normative, but also as a method of teaching. The latter form searches for the way "to enter the laws of pure practical reason into the human mind, to influence the maxims. The objective-practical reason can also make subjectively practical."[3]

Material ethics, which is concretely evaluated, examines which behavior is moral and can be differentiated from formal ethics, which provides methods for how moral behavior can be generated or determined. An example of formal ethics would be the rule that a just, and thus moral division of a single cake would be for the first person to cut the cake into two pieces and then the second one to select their piece.[4]

The term ethos is used when the individual chooses a part of morality as a basis for action, thus internalizes it (definition).[5] Virtues (definition), on the other hand, are practiced and internalized dispositions of inner attitudes, to do good, to behave ethically (definition). The Cardinal Virtues of Socrates and Plato were bravery, prudence, wisdom and justice. Virtues correspond to characteristics and are related to the persons. Aristotle (384–322 BC) concluded here by formulating "virtue is the way to happiness (eudaimonia)". Christian ethics supplemented these virtues by three more: faith, love, and hope.[6]

The heavenly virtues (and the contrary vices) of the Occidental Middle Ages were widespread by the musical work of Hildegard of Bingen in the Christian West

[2] See Ritter, Joachim /Gründer, Karlfried/Gabriel, Gottfried (1984), p. 149.

[3] Kant, Immanuel (1788), p. 269.

[4] See Göbel, Elisabeth (2010), pp. 45.

[5] See Schmidt, Heinrich (1982), p. 172 and Göbel, Elisabeth (2010), p. 10.

[6] See Götzelmann, Arnd (2010), pp. 17 and Schmidt, Walter (1986), p. 40.

of the Middle Ages: humility (arrogance), benevolence (avarice, greed), abstinence (lewdness), moderation (gluttony), goodwill (envy), diligence (laziness), patience (anger).[7]

Faithfulness, efficiency, consistency, thriftiness, reliability, cleanliness, punctuality, diligence, conscientiousness, patience, order and self-discipline are called secondary virtues. They have the nickname "secondary" because they are not directly moral, but are useful to society and are necessary for the implementation of moral actions. A good intention, such as caring for the elderly, cannot have a moral effect if discipline is lacking, and the care must be clean, punctual and orderly so that the old do not suffer any harm. In general, it is also possible to paraphrase the secondary virtues with a certain degree of certainty and reliability, which enables the good and expected implementation of a moral action. Secondary virtues are therefore also referred to as work ethos.[8]

Duties, goods and values are the basis of ethical action. Values are the highest guiding principles of human behavior. They can apply to groups or individuals. These conscious or unconscious orientation standards are the goal of all goods. Values are the fundamental conceptions of the desirable.

Values are positive occupied guidance (goals) for behavioral orientation (definition). A good example are the three values of the French Revolution: égalité, fraternité and liberté. Values that are relevant to the company or the economy are, for example, reliability, honesty, etc.

Values can apply to groups or individuals. These conscious or unconscious orientation standards are the goal of all goods. A successful life is the supreme value of Aristotle. (Born 384 BC in Stageira, † 322 BC in Chalkis).

Group Discussion: Value Clarification

Write your most important values in turn on a sheet in your script. In the following, your lecturer will help you to become aware of your most important values through open questions. This is called value clarification. Do you think that these values should also apply in the business world?

What are the most important values for you when dealing with people? The open method of questioning is named after Socrates' Socratic conversation. By discussing in the group, a group consensus can be established. Unlike television talk shows, it is not important to be right or to be good for the other participants, but to find the truth for themselves and the group.

Socrates applied a special open questioning technique to move people to self-knowledge (Socratic method, mäeutics, or even midwifery). It has been called midwifery because the questions raised something from the interviewees that had already been inside of them. This is a philosophical dialogue in order to gain an insight in an open-ended research process. A result of Socrates's ethics research is that the right action follows from the right insight. Moreover, according to Socrates,

[7] See Kirste, Reinhard and von Bingen, Hildegard.

[8] See Leisinger, Klaus M. (1997), p. 144 and http://www.familie.de/eltern/sekundaertugenden-foerdern-moral-538569.html

righteousness is a basic condition of souls' welfare. For him, it was worse to do wrong than to be exposed to injustice.[9]

Goods are the means to achieve values (definition). Goods are defined by ethics as special objectives or means to achieve the goal of a successful life. Goods are, for example, the objectives of human rights declarations such as health or life, freedom, peace, prosperity, security, property, environment, culture, but also the human community with its institutions (e.g. state and family).[10]

Duties are rules of action that result from norms (definition), whether as a sanctioned legal code of conduct or from morality and custom. Private actions and interests are only ethical or moral, thus socially legitimated, if they are based on socially accepted values.

1.2 What Is Business Ethics?

Business ethics (definition) is the science of morality and ethos in the economy (definition). The aim of this science, as part of philosophy, is to understand the rules of the world, and in particular the behavior of human beings, which includes not only the being of man, but also his normative expectations. In the case of business ethics as a science, the aim is to analyze the causes and effects of ethical and unethical economic behavior and to develop approaches to improve productivity with the help of ethics in order to provide recommendations for action for companies and policies.

Business ethics is the ethics of the economy and thus encompasses all kinds of human behavior at different levels of the economy. A part of this is the so-called corporate ethics or business ethics, which deals with the ethics of enterprises (meso-level), whereas manager ethics is concerned with the ethics of the enterprise, and thus is attributable to the microcosm. The micro level is concerned with the individual level, that is, the ethics of the economic operators. The macro level is concerned with the ethical framework of the entire economy (economic ethics). For example, the decision on the economic order (pure market economy, social market economy, socialism or communism) or the laws would have to be taken on the system level.[11]

Ethics in the company affects both the behavior of executives and employees among themselves as well as against third parties, other stakeholders. For example, customers are not allowed to be lied to about product properties and contract terms, balances are not falsified, nor bad company news kept secret against the lenders and

[9] See Störig, Hans Joachim (1997), pp. 152; Hersch, Jeanne (1981), p. 274; Schuschanaschwili, G G. (1987), pp. 855 and http://www.paradisi.de/Freizeit_und_Erholung/Kultur/Philosophie/Artikel/22607_Seite_9.php (15.04.2015).

[10] See Korff, Wilhelm (1999), p. 312 and Göbel, Elisabeth (2010), p. 155.

[11] See Kreikebaum, H. (1996), p. 14 and Dietzfelbinger, D. (2008), p. 30.

shareholders. Dependencies (e.g., from vendors) should not be exploited.[12] From this point of view, the problem of ethics is a natural part of a market economy based on the free action of individuals.

Why do we need business ethics at all? Is it not enough to let the market forces work? Why should an economic subject be ethical, and why is ethics important to society? Although the answer to this central question is still being elaborated in detail, it should already be answered in principle:

1. To avert damage to economic activity for third parties (interest of society)
2. To avert damage to economic activity for the company (interest of the company)
3. To increase the productivity of interpersonal cooperation (interest of the company and society)

This results in two conflicts of interest for the individual: the individual pursues his own interests and conflicts with the interests of society. In extreme cases, he can even maximize his utility at the expense of society (individual versus society). This conflict of interests also often arises against the company as an employer (individual versus company).

So-called moral hazards promote such conflicts of interest as negative behavioral incentives. A moral hazard is an incentive for the individual to behave against, or at the expense of, the public (collectively, for example, society or company) (definition).[13]

Such negative incentives (perverse incentives) are often responsible for faulty developments and productivity losses. For example, in the financial crisis the American intermediaries were paid for subprime credits by credit volume. The consequence was that the repayability of the loans was no matter to them. More and more loans were given to ever-worsening borrowers. In the cases of ENRON and Worldcom, bonuses after a short-term increase in the share price led to the manipulation of the balance sheets in order to increase share price increases by means of higher profits.

1.3 Objective of Business Ethics

The moral preoccupation with which the economy is confronted is ancient. Aristotle (384-322 BC) distinguished between natural acquisition or acquisition and enrichment (chrematism), which he condemns, because it is not given, but is based on the weakness of man. The pursuit of money becomes a self-interest, which removes man from his natural destiny, namely the elementary need-satisfaction for a good

[12] See Göbel, Elisabeth (2010), p. 202.

[13] The Moral Hazard theory comes originally from the Principal Agent Theory. Here, the incentives for the agent to enrich themselves with rational utility maximization at the expense of the principal. See Schnebel, Eberhard/Bienert, Margo A. (2004), p. 205.

life. Aristotle puts virtue over the economy because man can only achieve his happiness through the exercise of his virtues. The perfect virtue for Aristotle is justice, which serves as a measure of the economy. He does not see any need for justice, as is the case with socialism, because unequal should not be made or treated as equal. According to Aristotle, there must also be a balancing justice, which compensates for unlawful distributive results, for example from fraud.[14]

Business ethics thus puts people above the economy and assumes that the economy is to be used by man. However, there are also other opinions, according to which the economic success justifies the means. Economy is then faced with morality. Economic success is a sign of God's benevolence according to Calvinism. Economic success is thus more than just morally legitimate, it indicates God's chosen. There can hardly be any greater incentive for active pursuit. Hard work and asceticism are therefore the basis of a successful Calvinistic entrepreneurial personality.[15]

Originally, the economy and ethics were interconnected. According to Aristotle, the purpose of economics as an art of household management was to provide the means to enable a happy life for man. The economics should solve the problem of scarce resources, which means to ensure their efficient use so that the welfare could be maximized, thus enabling a life to unfold human potential. This was the ethical purpose, and thus the goal of economics. Prosperity was not an end in itself.[16] The long-term maximization of profit was the first step towards the development of business economics as a separate discipline. Added to this was the maximization of the shareholder valuation. It was thus left to the remaining national economics (national economy) to ensure that the maximization of profits also leads to a welfare maximization. According to Aristotle the "art of gainfulness" and "the pursuit of maximum wealth" explicitly do not belong to economics.[17] Aristotle does not see the goal of "increasing money to the infinite"[18] as a meaningful, happy, human goal.[19]

For Aristotle, economics is the art of making goods for the satisfaction of vital needs. The goods that are necessary for life are thus also moral, because they are the basic prerequisite for survival and beyond, the basis for a "perfect life," the human potential of striving for supreme value and for happiness.[20]

Modern business management does not distinguish between moral and immoral goods. The benefit for people and their purchasing power drives decisions. A social evaluation is intentionally dispensed with. If a person is willing to spend money on

[14] See Aristoteles (1960), p. 196 und p. 358; See Aristoteles (1991), pp. 22 or 1257b und 1258b and Schefold, Bertram (1989), p. 19–55.

[15] Already Max Weber saw in the Protestant and Calvinist influence a cause for the positive economic development in Switzerland, the Netherlands, England and parts of Germany. See Weber, Max (1905); Ulrich, Peter (1993), pp. 1168 and Noll, Bernd (2002), p.166.

[16] See Aristoteles (1991), pp. 22 or 1258a, b, 1059b and Aristoteles (1960), pp. 5 or 1094a,b, 1095a.

[17] See Aristoteles (1991), p. 27 or 1258b.

[18] See Aristoteles (1991), p. 26 or 1258b.

[19] See Aristoteles (1991), pp. 22 or 1257b and 1258b.

[20] See Aristoteles (1991), p. 23 or 1256b and Aristoteles (1960), pp. 8 or 1095b.

a good, the utility and satisfaction of a need is assumed. The preferences of the consumers are perceived as subjective and given no objective assessment. The goods that are sold can be immoral, such as pornography or even directly harmful such as drugs, as far as the legislator permits. The goods are therefore equivalent to medicines and basic food.[21]

The business administration has separated itself from morality and pursues a purely material goal with the maximization of profit, which can be quite immoral: how the money is earned does not matter. This is also scientific, inasmuch as the natural sciences are also researching without morally evaluating or even regulating research. The discovery of atomic energy has enabled both the use of this energy form and the development of the atomic bomb. Ultimately, however, it is also clear that a society cannot be allowed to do this. It must prevent this kind of science from being used against it. The question of the benefit or harm to man and to the society must be posed as early as possible and answered in order to forestall societal damage.

Ethics traditionally ranks the social benefits above the individual benefit. For Kant (b. 22 April 1724 in Königsberg, Prussia, † 12 February 1804 ibid), an action is especially moral (moral) when it benefits others at expense to one's own benefit.

> … there still remains, as in all other cases, a law, namely, to promote his happiness, not out of affection, but out of duty, and so his behavior first of all has the real moral value.[22]

It follows from Kant's considerations that, in those cases where the welfare of others or the common good (or company) is opposed to one's own, the welfare of others is at least accepted as equivalent. Under no circumstances should the pursuit of one's own happiness, or one's own benefit maximization be carried out at the expense of the others, or that of general wellbeing. And when in doubt, morality, that is the wellbeing of others, must be placed above one's own. For this purpose, one's attitude is important in order to be moral and be of benefit to others.

Kant does not demand self-sacrifice, since man is explicitly to pursue his own happiness.[23] Rather, he is striving to find his own happiness in the pursuit of the happiness of others. In the consistency of happiness and morality Kant sees the "highest good" as the ultimate goal. At the same time, he sees it as a human duty to shape the world in such a way that people can also be happy in this.[24]

Business ethics therefore has the important purpose of countering the common good of the economic individual benefit maximization. This is one task of business ethics. Another is to demonstrate the productivity advantages that result from ethical behavior for the company and society. This indirectly promotes ethical behavior.

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[21] See Stigler, George J./Becker, Gary p. (1977); Ulrich, Peter (2001), pp. 2 and Wöhe, Günther (2008), p. 17.

[22] See Kant, Immanuel (1785), p. 25 or BA13.

[23] See Kant, Immanuel (1785), p. 25 or BA13 and Kant, Immanuel (1797a), p. 518 or A18.

[24] See Kant, Immanuel (1788), pp. 216 or A166, 223,225, 234. "The moral law requires the highest possible good in a world to make me the ultimate object of all behavior. This, however, I can not hope to effect, but by the agreement of my will with the holy and benevolent maker of the world,… "Kant, Immanuel (1788), p. 261 or A233.

Business ethics is thus legitimate when it asks whether the economically active people, or the institutions and organizations, are good because they are good for the human community. Thus, business ethics can be reduced to the question of what economic activity or the economy as a whole or in parts brings to man, society and business. Business ethics thus puts people above the economy and assumes that the economy is to be used by man.

There are also different concepts in European business ethics. One can differentiate into corrective, functionalist and integrative approaches. In the corrective approach, the unethical effects of the economy are to be corrected by business ethics (Principal Agents Horst Steinmann, Albert Löhr and Peter Koslowski). In this concept economics has to be subordinated to ethics and is improved normatively. Functional business ethics considers ethics a means of increasing the productivity of the economy. Ethics thus becomes a means to an economic end (Karl Homann). The same goals are pursued as the economy. Integrative business ethics by Peter Ulrich, on the other hand, strives to reveal the ethical effects of the economy and to orient the economy more to the life demands of the people.

Conclusion and Summary
Business ethics is intended to ensure that economic activity works to the advantage of others and thus complements business management and economics.

Comprehension Questions
1. Define business ethics.
2. What is meant by moral, morality, norms, ethos, and virtues?
3. In your opinion, have you considered moral aspects adequately in your previous business training or do you think this is superfluous?

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Chapter 2
Ethical Valuation Approaches

What Follows Why?
This lecture chapter explains the classical and modern ethical evaluation criteria for human action. They should serve as a basis for evaluating economic action.

Learning Goals
Students should be able to apply the classical and modern ethics concepts to economic action.

How should one behave morally in the economy?

2.1 Classical Ethics

Case Study: Relations and Recommendations
A works in a bank. B, who does not know A, asks him to give him a job in his bank. How would A behave morally, and how ethically? Discuss the right behavior.

1. A will help him and recommend him. B is lazy and also steals from the bank.
2. A will help him and recommend him. B will be a grateful and loyal employee. The bank is grateful to A.
3. A says no, because he does not know B and only stands up for something he believes in. B goes to the competition and becomes one of their best employees.
4. A says no, because A does not know B and is only willing to recommend what he is sure is a good person. A meets B in a year in the pub again. Because of his financial problems and the resulting bad mood, his wife left him.
5. A says no because A does not want to help B. What has A to do with B, B should help himself. A meets B in a year in the pub again. Because of his financial problems and the resulting bad mood, his wife left him.

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How should one behave morally in this situation? What is right? The above example shows that one can see the same situation differently and can behave differently morally.

2.1.1 Ethics of Conviction

One can focus on the mind; the motivation or intention. Accordingly, it would have been sufficient to mention the prospective employee to the personnel department in order to help him. Not mentioning him to the personnel department would have been moral if it was intended to protect the bank. According to Immanuel Kant, the "good will" and not "the ability to achieve a purpose" is decisive for an ethical evaluation:

> There is nothing in the world, or at all, to think outside of it, which, without limitation, can be considered a good intention…[1]

> Good will is not determined by what it affects or effects, not by virtue of its suitability for the attainment of any superior purpose, but only by the will, in itself, good …[2]

In Kant, the mind ultimately determines whether an action is to be classified as moral. If looking in on your old aunt it is a duty, but not a moral one, if you do so only to be considered in the inheritance:

> I also set aside the actions which are really duty-bound, but which are not directly affecting men, but which they nevertheless exercise, because they are driven by a different inclination. For it is easy to distinguish whether the duty-related action has been done for duty or self-seeking.[3]

According to Kant, a good or good-maximizing deed would not be classified as moral if it is done for the sake of pleasure, instead of out of a pure commitment to duty. Kant offers the example:

> A shopkeeper is honest with a naive, easily duped customer, not because it is his duty to be honest, but because it will help build his good reputation, and his business. He acts in accordance with duty (he is honest) but not from duty (ie not because honesty is right whether or not it helps his reputation and business)…[4]

For today's society too, ethics of conviction is central. "Good will counts" and even courts of law distinguish between premeditation and negligence. Ethics of conviction also corresponds to conscience. If we have a clear conscience, we think we have done everything right, especially since we often cannot ignore the consequences of our actions. Thus, in cases 1 and 2, a good will exists, but the effects of the action are negative and thus unintended.

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[1] See Kant, Immanuel (1797a), (C), p. 393.

[2] See Kant, Immanuel (1797a), (C), p. 394.

[3] See Kant, Immanuel (1785), (B), p. 397.

[4] Kant, Immanuel (1785), (B), p. 397.

But what about the consequences? Is it enough to want good? No, unfortunately not. Otherwise, every fanatic, every terrorist would be a morally acting man, even though he harms many people. It would depend only on the subjective assessment by the actor, his, in his opinion, positive attitude. Well meant is not well done.

There are people who are particularly convinced they always know what is good. This has the consequence that they also know better for others what is good for them. They thereby patronize others and impinge on their freedom. They accuse others of being immoral and yet it is often a point of view. Do they really know better? What is the right behavior? As a rule, the information on the consequences and, in particular, the impact and the assessment of the affected persons are missing. A basic problem with ethics is that one cannot look through people, what they have thought about their behavior, what their motivation was. Every judge has to deal with this problem if he is to decide whether an action with a negative effect for third parties was intentional. The intent distinguishes murder from manslaughter and thus also clearly the penalty changes. In addition, even the actor can often not determine the motives that have guided him, since he can also be influenced by the subconscious.[5]

People are very different and sometimes not rational, or rather emotional and irrational for many reasons, whether predisposition, indoctrination by religion or ideologies. Georg Wilhelm Friedrich Hegel (August 27, 1770 in Stuttgart, Wuerttemberg, 14 November 1831 in Berlin, Prussia) lends absurdity to ethics by saying that ultimately any crime can be justified as long as it was committed only with good intent or with good conscience.[6]

In principle, an ethics of conviction would suffice to produce good behavior for mankind if all men were to have the same perceptions and objective reason, in order to correctly assess the consequences of their actions. Kant doubts this, which is why in his work Metaphysics of Morals he develops a duty ethics for general human behavior (deontological ethics, from Greek to déon: the necessary, the duty). In addition, he developed imperatives or rules as an aid to the practical reasoning about human coexistence: a categorical imperative and a practical imperative as well as the publicity rule. The conviction of the agent to do good has to be added to the dutiful action.

2.1.2 Kant's Rules for Ethical Reasoning

2.1.2.1 The Practical Imperative

The practical imperative:

> Act in the way that you use humanity, both in your person and in the person of each other, at any time not just as means but also as a purpose.[7]

[5] See Grünewald, B. (2010), pp. 99.

[6] See Hegel, Georg Wilhelm Friedrich (1820), § 140.

[7] Kant, Immanuel (1797a), (C), p. 429.

How do my actions affect people? The purpose of my action should be to do good, or at least not to harm anyone. We should therefore take into account the purpose, which means the effect on other people, and not regard humans as a means, i.e. without the effects of our actions, on our actions or behavior, which also includes allowing inaction. We should therefore take into account the purpose of an action, the effect it will have on other people, we should not regard humans as a means separate from the effects of our actions, including the decision not to act.

For example, customers should be seen not only as a means to gain profit by selling the products to them, but also to take into account the effect on them through the product, e.g. do not sell rotten meat to customers. Kant, however, also refers to the agent himself. He should not regard himself as a means, but also as a purpose, and therefore not harm himself. In current situations this would mean that a manager should not harm his health, just to further his career.

2.1.2.2 The Categorical Imperative

For Kant, maxims are guiding principles that people give themselves. In addition, there are still universal human laws, which are categorically valid.[8]

The categorical imperative:

> Only act according to the maxim that you can make a universal law.[9]

This is to be the guiding principle for ethical action. This means that the actor should ask himself whether his behavior satisfies a principle that he also wishes to find generally applied in society. All human beings would behave in this way, and the agent would be exposed to the same behavior from other people. The first case corresponds to the question often heard as a child: "What if everyone did that?" If you would like to take a little stone as a souvenir from the Acropolis, this might be socially acceptable as a single action, but not if all people behave like this. Then there would soon be no more acropolis. So there can be no exception to the rule.

The second case corresponds to the popular saying: "What you do not want to done to you, do not do to anyone else." Here, the agent is supposed to put themselves into the situation of the person affected by their behavior. If action leads to the person to be better, the action is not only socially problem-free, but also desirable.

Lying to other people for one's own advantage would, for example, contradict the categorical imperative, since one does not want to be lied to. If someone in the workplace is rude to colleagues or even mobbing, he should ask himself whether he wants to be treated like this.

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[8] See Schmidt, Walter (1986), p. 47.

[9] See Kant, Immanuel (1797a), (C), p. 421.

2.1.2.3 Publicity Rule

Kant develops yet another rule to establish moral action:

> All actions related to the right of other people, whose maxim is not compatible with publicity, is wrong.

That is, the behavioral rule is such that if the agent would fear the response of his community should his actions become public, we assume that the rights of others are unfairly, thus disproportionately, affected. One should ask oneself whether those affected by an action would approve of it. For example, if a pharmaceutical company conceals the side effects of a drug, the publicity rule would be violated because the patients would not understand the dangers to their health.

2.1.3 Ethics of Duties (Deontological Ethics)

The approach of regulating human coexistence via obligations is already found in the ten commandments of the Bible and has been repeatedly taken up within the framework of philosophical ethics research. The doctrine of duty, doctrina de officiis (Latin: "of duties" or "dutiful action"), was written by Marcus Tullius Cicero in 44 BC and is one of the standard works of ancient ethics.

De officiis consists of three books wherin the duties of daily life are identified, especially those of a statesman. The first deals with honorable behavior, while the second deals with the duties useful to man, and the third book deals with situations in which they may conflict. In the first and third books he also refers to the four cardinal virtues.

Cicero refers to the doctrine of the Stoic Panaetius (died 111 BC) (peri tou kathêkontos) and Panaitius of Rhodes, but also draws on other ancient philosophers such as Poseidonius and Plato. Kant subdivided his definition of duty "Metaphysics of Morals" into legal and virtue doctrines, according to the distinction between legal and virtuous duties.[10]

Duties are what should be done from the ethical point of view. They are the opposite of values as ethical principles of behavior, which man himself has voluntarily accepted. Duties are imposed by society and values are the voluntary ethical guidelines.

Depending on social orientation, Kantian universal duties become laws and norms or even parts of religions or ideologies. Duties in the narrower sense are also laws. Without a moral attitude, according to Kant, adherence to laws is not a moral act because the actor ultimately only wants to escape punishment.

Duties (definition) are rules of action that result from norms, be it as a sanctioned legal code of conduct or from morality and custom.

[10] See Bührmann, Mario (2008), p. 126 and http://www.zeno.org/Kirchner-Michaelis-1907/A/Pflichtenlehre (15.04.2015).

If a society has many plural groups or sub-societies (pluralistic society), it will also have many different and contradictory norms, as each sub-society has its own. If a person moves in different sub-companies, he must inevitably violate the norms of the sub-companies with his behavior. Duties as coercion and values as goals are the basis of ethical action.

Religions consist of duties, binding norms of action. Ultimately, it is the goal of all religions to regulate human coexistence with the claim to sole representation, so that the happiness of all is maximized. They differ with regard to background history as the basis of faith and the weighting of duties and values. Every religion has different duties, but those who regulate living together are similar because of their necessary functionality. Religions, however, also convey meaning for human existence. They answer questions of human existence in the world. They contain an explanation of the origin of all life, of the world's creation.

In religions there are ethical rules, which are intended to define the distinction between good and evil and thus prevent damage to third parties, to society. From this point of view, an ethical direction and morality as a society-dependent custom is the core of every religion. The religions thus fill important social functions. Conversely, one can conclude that in the absence of religions a social ethical vacuum is created. Values are no longer conveyed by the religious representatives, and duties are no longer prosecuted, controlled and sanctioned in case of disregard. Because of the diminution of the Church's influence on the ethical education of the human being, teaching ethics in schools is currently chosen as an alternative.[11]

Even if it is difficult to believe in religions, one must respect and support their social function. In all countries, they are an indispensable part of a functioning society and difficult to replace by teaching abstract ethics in public schools. The religions did not succeed in proving their myths or the existence of a god. On the other hand, science and atheists did not succeed in proving the opposite, that is, the absence of a god. Although scientists provide an explanation for the origin of all life, these are just plausible explanations. They have yet to offer a hard proof of the origin of all things, the existence of matter at all. Seen in this way, a creator can always be accepted in whatever form. Nor did Darwin's explanation of evolution provide the reason for the existence of life and its development, but only the explanation for the development. Why this is so, or where the blueprint for evolution, or the path for development, comes from, he could not explain. The same applies to the so-called decoding of the genetic codes.

According to Kant, the duty is "the action to which someone is connected."[12] Kant concretizes human duties. Man should respect himself. Self-mutilation and suicide are prohibited. Rather, the body and the mind should be cultivated and developed. Their own potentials are to be developed, including self-knowledge and conscience education. For this, a minimum of prosperity is needed, since poverty

[11] See Göbel, Elisabeth (2010), p. 320.

[12] See Kant, Immanuel (1797a), (C), p. 222.

necessarily leads to vice.[13] All duties fulfill the criteria of the categorical imperative.

For Kant the duties to other people include respecting their dignity, helping them in need, being grateful and conciliatory, not deceiving them, not lying, nor mocking or slandering. As inner attitudes, he demands virtues such as benevolence, compassion, gratitude, truthfulness and integrity. Negative inner attitudes or characteristics (virtues), on the other hand, are envy, dislike, pleasure in the pain of others, arrogance, revenge and greed. Economic obligations are respect for the laws and the property of others, the observance of contracts and the payment of debts. As a principle of individual freedom, "the freedom of arbitrariness of everyone can co-exist with everyone's freedom in accordance with a general law."[14] This corresponds to the principle of modern democracy that the freedom of the individual stops where the freedom of the other begins. Individuals are not allowed to exercise their freedom without consideration or to the detriment of others.

Ethics needs freedom because only a free living being has the choice between different decision-making alternatives. "For since morality serves us merely as a rational being for the law, it must also be valid for all rational beings, and since it must be derived only from the quality of freedom …"[15]

Kant's overriding goal of human existence is the pursuit of one's own perfection and alien happiness.[16] He sees it as the task of practical philosophy "to prevent the aberration of a still crude and untrained judgment."[17] And "… the way to wisdom, which everyone must take, to make good and recognizable." The morally judging reason is to work out obligations that enable a happy coexistence of human beings.[18]

For Kant, right action sequences are automatically derived from the ethics of conviction and the ethics of duties.[19] However, he does not see the consequences as a suitable evaluation basis for moral action. One reason for this attitude is that, in his opinion, the consequences are too often dependent on chance to be responsible for human beings.[20]

Kant formulates universal ethical principles using only logical reasoning without presupposing theological claims or a metaphysical conception of good, which establishes a rights ethics. He is stressing an account of justice and rights with cosmopolitan scope.

> Let justice reign even if all the rascals in the world should perish from it. This appears in his 1795 "Perpetual Peace" ("*Zum ewigen Frieden. Ein philosophischer Entwurf*"), Appendix 1

[13] See Kant, Immanuel (1797a), p. 518 or A18.
[14] See Kant, Immanuel (1798), p. 337 or B33.
[15] Kant, Immanuel (1785), p. 82, BA 100.
[16] See Kant, Immanuel (1797a), p. 515 or A 13.
[17] See Kant, Immanuel (1788), p. A 292.
[18] See Kant, Immanuel (1785), (B), p. 398.
[19] See Göbel, Elisabeth (2010), p. 23.
[20] See Kant, Immanuel (1798), p. A 310.

Kant argues that there is *a priori* a natural system of private right, which is built on reason. There are natural moral principles that govern interaction between private persons, which can be deduced from logical reasoning. One person's private rights end where the rights of others are infringed upon, which is why we should use the categorical imperative to determine if the rights of others are affected. According to the categorical imperative everyone has the same rights and should be treated equally. This imperative is categorical thus universal law. These rights form a universal constant that does not change depending on circumstances. They form a universal rational morality.[21] If there is a natural system of rights and freedoms for people there must be an enlightment to realize them: "Enlightenment is man's emergence from his self-incurred immaturity."[22]

Duty ethics helps where the ethics of conviction is not reliable, because the good is subjectively distorted, or simply because people are intellectually overburdened. In the latter case, the categorical and the practical imperative will overwhelm some people. Even if the ethics cannot be reasoned through it does not release one from fulfilling duty ethics in the narrow sense. Duties or standards provide clear instructions for action and can be memorized and practiced. But what helps when duties are contradictory and reasoning with the Kantian imperatives does not help? What if negative consequences arise from the duties? Let us take the duty "You shall not lie". Kant sees truthfulness as a top priority, for which there can be no exceptions, even if a murderer asks for the whereabouts of his victim, one must tell him the truth, even if the victim is then murdered. In such a case one is not responsible for the consequences.[23]

> The greatest violation of the duty of man to himself, considered only as a moral being (mankind in his person), is the antithesis of truthfulness: the lie (aliud lingua promtum, aliudpectore inclusum gerere) … Through them he makes himself in others, but through these, what is still more, in his own eyes the object of contempt, and violates the dignity of mankind in his own person ….[24]

In an extreme case, two duties can also contradict each other and lead to tragic dilemmas. Let us take the current euthanasia discussion as an example. The prohibition of killing and the cessation of assistance prohibit the physician's euthanasia, even if the patient explicitly wishes for it and suffers a great deal. This is a contradiction to the assistance offered and the principle of human dignity and the welfare of the physician against the patient.

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[21] See Arthur Ripstein (2009), pp. 145

[22] Kant, Immanuel (1784).

[23] See Kant, Immanuel (1797a), p. 425 and 428. Kant confessed to his statement, and in 1797 addressed an essay against the French philosopher Benjamin Constant, who had expressed the opinion: "The moral principle: it is a duty to tell the truth if one were to take it absolutely and singly, it would make every society impossible.We have the proof of this in the very immediate consequences which a German philosopher has drawn from this principle, which goes so far as to assert that the lie against a murderer who asked us whether our friend whom he had persecuted did not enter our house Escaped, would be a crime." Kant, Immanuel (1797b).

[24] See Kant, Immanuel (1797a), (C), p. 429.

Case Study: Colleagues

Group work: Discuss in groups of 3 how to behave in cases 1 and 2.

1. Let's say A promises a 20% discount to a customer. The colleague B knows that the customer is compensated with a huge Christmas gift every year. Your boss asks B why the price is so low? B says the truth because B does not lie. Colleague A, a family father, is terminated. Here the consequence of the statements were catastrophic for A. From a sense of fellow humanity or compassion B would better have said nothing, right? But what if B had said nothing and because of this order the company goes into the insolvency?
2. You don't lie. Her colleagues claim they have acquired many new customers. Instead, they were mediated by the subsidiary. Colleagues are promoted, you are not.

Solution

1. You have the choice between the alternatives, to protect the colleagues or lie to the superior. In these cases, it is important to weigh the results of the action. They might decide not to betray their colleagues because they want only good for them. Colleagues have to stick together. Ultimately, the consequences are not foreseeable. If the company could be at stake, you must inform the supervisor. They are not responsible for the consequences for A. A had to know that his behavior was not correct. A makes you his friend when you cover him. Then your job is at stake when it was bribery. However, it would also be conceivable that the 20% price reduction was necessary in order to acquire the business in competition, and the Christmas gifts were also customary in the industry. In any case, you must inform the supervisor.
2. Here not lying has negative consequences. Such a thing can tend to be more likely to occur in large companies, which also have poor controlling. The performance of employees is more transparent for smaller companies. In the normal case, it would be the task of the superior to take action against arrogance and unfair results manipulation. The response of the supervisor, however, depends on your relationship to him and his leadership style and character. If you complain about your colleagues it may be misunderstood as envy, or the boss sees in you a Job who causes him anger and you may get the sharp edge of his displeasure and end up worse than if you had accepted the injustice.

In the group discussions within the framework of the seminar events the reactions are very different. Some students report the injustice to the supervisor, but many seminar participants decide not to do anything. This is the best decision from the company's point of view and also brings considerable disadvantages to the employee. From the company's perspective, bad performance is rewarded and even a less productive and an immoral employee is promoted. The productivity and the operating climate suffer. This decision has a signal effect on other employees. Unethical behavior is worth more than the performance in the company. The employees will behave accordingly in the future, and the employees who cannot or will not keep up with such behavior will terminate internally. In addition, unproductive and unethical employees were promoted to supervisor, with a corresponding influence on the company. This will also have a negative impact on company productivity and employee satisfaction, as demonstrated in the chapter on leadership ethics. For the honest employee who has been silent, this can be a problem. The former colleague is now the boss and would like to get rid of his former colleague, if he has to fear that they have leverage over him. All in all, the affected employee should ask himself whether or not to inform the supervisor. If this is not feasible, the company appears to have a management problem and an ethical problem. In this case, it would be better to quit and switch to a better company than accept the disadvantages of one's own career and work satisfaction. But there is also a third solution. The employee can try indirectly to check the performance figures by controlling, for example, by launching a problem, which cannot be directly linked to his actual motivation.

2.1.4 Ethics of Responsibility or Ultimate End (Teleological Ethics)

Max Weber criticizes the ethics of conviction because of the limited rationality of the actors and unpredictable and thus possibly immoral consequences.

> If the consequences of an action flowing out of pure conviction are evil, it is not the agent but the world that is responsible for it, the stupidity of the other men, or the will of the God who created it so. The ethicist of responsibility, on the other hand, reckons with just those average defects of men. He, as Fichte rightly said, has no right to prescribe his goodness and perfection; he can not shift the consequences on others of his own actions as far as he could foresee them.[25]

Like Mill,[26] Weber criticizes the Kantian duty ethics because of the unavoidable dilemma and conflict situations resulting from contradictory duties. He gives two examples of duty ethics that lead to immoral consequences. Thus, the Kantian duty of truthfulness would make the preservation of state secrets impossible, even if this would cause great damage to the country. The Christian commandment of non-violence would, consistently implemented, lead to the inability to counter violence, which would lead to further violent acts. Weber sees a danger that people, especially government decision-makers, will be responsible for their decisions by referring to appropriate duties. He demands that people have to bear responsibility for the foreseeable consequences of their decision, and also act morally.[27] This can also be transferred to politics and business. Responsibility for one's own actions is what Eucken has understood as an important prerequisite for a functioning market econ-

[25] See Weber, Max (1919), p. 442.

[26] See Mill, John Stuart (1863), Chapter one.

[27] See Weber, Max (1919), pp. 441.

omy, when he spoke about the liability for economic decisions.[28] For example: A company runs a discount deal. However, a sales employee notes that the production costs have now risen and are above the sales price. However, it is not his responsibility to inform the supervisor about this. According to duty ethics in the strict sense, he does not have to. According to the ethics of responsibility, he is responsible for the consequences if he does not act.

Max Weber propagates his ultimate end as an ethics of responsibility, consequentialism (also called teleological ethics after the Greek télos, the goal, the purpose). The actions are moral when they achieve good. This principle is the basis of our jurisprudence "knowingly accepted" or "gross negligence" is interpreted by our courts as fault. Having followed an order (duty ethics in the narrower sense) is not accepted as an exculpation argument. Before the Nuremberg court many Nazis had used their orders to kill as excuses for their actions. In the current social norms, however, orders do not set a person free from responsibility for his actions as a person. Of course, a moral condemnation of murderers would be difficult if they had been killed themselves as they had disobeyed an order to kill.

In general, the ethics of responsibility is very demanding and therefore not always an applicable measure. It is not always possible to clearly assess the consequences of the actions. Either there are too many influencing factors or the result depends simply on chance. Furthermore, teleological ethics presupposes not only a high level of information, but also a high intellectual and moral capacity from the actor if the consequences of options for action are not only to be foreseen, but their results are also weighed against each other. How is the doctor to act when it comes to decision-making at a birth in which only the life of the child or the life of the mother can be saved? Does a doctor act morally when he provides euthanasia or when he refuses? Here, the action is already so deeply rooted in human life that even society as a normative does not appear to be adequately legitimized in order to prescribe an act as a norm. This is where we encounter ethical limits.

Ethics of responsibility is one of the most important ethical evaluation criteria. Much is legal, but can we accept the consequences for others ethically? The overfishing of the seas was legal, but the consequences for third parties are catastrophic and thus not legitimate. Without impact ethics society could not adequately address the challenges of new technological developments. Mobile phones lead to loud conversations, for example on trains where other passengers wanted to read. Courtesy or consideration as a social standard or as its own value would dictate that phone calls should be made at a distance from other passengers. Meanwhile, there are also areas where telephone calls are prohibited. Smartphones with a photo function connected to Facebook and WhatsApp bring new challenges to privacy. However, challenges are also created, for example, by air pollution and the noise generated by production. In some metropolitan areas, for example, a new conflict arises from a globally growing economy in transport. Air transport has risen very strongly in recent decades. Many residential areas in cities like London or Frankfurt are exposed to considerable noise and exhaust emissions.

[28] See Eucken, Walter (1952).

Ethical dilemmas can also result from applying the ethics of responsibility. An ethical dilemma can be represented formalized as follows: It is necessary to do a, and it is necessary to do b, but we cannot do a and b at the same time.[29]

Group Discussion: Ethical Dilemmas
Discuss the familiar trolley dilemma (see below). Is there an ethically correct solution?

A tram has run out of control and threatens to overrun five people. By switching a switch, the tram can be diverted to another track. Unfortunately there is another person there. Can the death of a person be accepted (by moving the switch) in order to save the lives of five people?

One solution is offered by utilitarianism.

2.1.5 The Utilitarianism of Jeremy Bentham

In order to weigh the consequences of actions on others, one must evaluate them. An extreme approach in the form of a quantitative impact assessment is provided by so-called utilitarianism, one of whose founders is Jeremy Bentham (born February 15, 1748, near London, 6 June 1832, Westminster). It is a pure ethics of responsibility in which the conviction does not matter, but the greatest happiness of the greatest number, or the principle of the greatest happiness (principle) of all men. It is therefore about the determination of the net happiness resulting from actions and their maximization. Joy and suffering are offset against each other individually as well as in between all the people affected by the action. The action with the greatest net happiness is the most moral.[30] The answer of utilitarianism to the solution of the trolley dilemma would have been saving the five people at the expense of the one person.

Utilitarianism in economics has become known as benefit maximization. “Utility” has a different meaning than the word “happiness”. Happiness makes Bentham’s approach more equitable, since “pain and pleasure” meant pain and joy. It is only today that this is taken up again in the context of happiness research. For Bentham, for example, happiness comes from a sense of goodwill, a good reputation, wealth, power, charity but also negatively occupy characteristics such as disgrace. Suffering results from deprivation, a bad reputation, enmity, and pleasure can arise from from charity, piety and misery. In the case of charity, one gives to others and feels happiness. In the case of malevolence, one feels pleasure when others are wrong.

Group Discussion: Utilitarianism
Discuss this approach. Is this consistent with your ethical ideas?

[29] See Eberhardt, Joachim (2015), [19].

[30] See Bentham, Jeremy (1789).

Criticism about this approach is generally its hedonistic orientation, thus the strong ego and pleasure-seeking. This kind of morality does not correspond to the idea of good found in Plato, Aristotle, and Kant. Ultimately, everything that spreads joy is weighted equally. Is it possible, for example, to equate joy from malevolence and lustful pleasures with the joy of charity, and to calculate it for a net profit? John Stuart Mill, the son of James Mill, the co-founder of Utilitarianism, and his pupil Jeremy Benthams, cites critics with the term "Pig Philosophy".[31]

The autonomous utility of the community or society is not considered here, but only the sum of the individual benefits. As we shall see later, this is not the same, since the benefit of all individuals is increased by the community (superordinate rules) (emergence). Autonomous utility results mainly from the division of labor.

Our democratic principle at least partially corresponds to this approach: the majority can always make decisions to the detriment of the minority, because it is assumed that their utility is greater than that of the minority.

A further point of criticism is the calculation of benefits for different people. This may be applicable in a welfare economy, for example in the consideration of external effects of large-scale projects, since these are not extreme benefit impairments. But what is the balance of one human life against another? Is it moral to sacrifice a few to save many? Ultimately, the use of soldiers in war is always justified by higher goals, which are often not rooted in truth.

Ultimately, one cannot calculate the amount of joy and suffering in an absolute and quantitative way. Ad absurdum, it would be possible to justify the torture of human beings with utilitarianism even if a sadist feels more joy than his victims. The sacrificing of slaves in the Circus Maximus of Rome would be justified if many thousands of spectators felt more joy than the few slaves felt pain. There would be a positive net-happiness. Utilitarianism in the narrower sense is not an ethical approach because the welfare of others is not the focus. The approach is ethical inasmuch as the greatest general happiness, as the happiness of all men, is striven for. In this case, damage to third parties is acceptable.

Rule utilitarism provides an alternative approach to the act utilitarism. Rule utilitarianism does not encourage the individual action that provides the greatest happiness, but rather the general rule that maximizes happiness. The difference lies in the overall happiness of the society, which is the outcome if gereral rules are followed. If we use rule utilitarism in our example, the torture of human beings could not be justified, even if a sadist feels more joy than his victims. As a general rule torture would not maximize utility to society, since the utility becomes negative if everybody tortures others. The sacrificing of slaves in the Circus Maximus of Rome could not be justified, as there are not just thousands of spectators feeling happy, but also an infinite number of victims feeling pain that reduce happiness. Another advantage of rule utilitarims is that there is not a special calculation for every decision or action needed, as with act utilitarism. Either the actor can use his imagination to

[31] See Mill, John Stuart (1992), p. 86. "the principle of utility, or as Bentham latterly called it, the greatest happiness principle" Mill, John Stuart (1863), Chapter one.

deduce the results of applying the rule or he can use a given set of rules that maximize social utility.[32]

Nonetheless, there is also an account of the pleasure and pain of different people in our Western democracies. When a judge decides on the expansion of an airport, he takes into account the interest of the general public in the form of jobs and a good traffic connection if he approves the complaints of the residents. In the case of aircraft catastrophes such as 9/11, there are launch orders, which are intended to minimize deaths in inner cities. Here the passengers of the machine are sacrificed to prevent more dead on the ground.

2.1.6 Millian Utilitarianism

John Stuart Mill (born May 20, 1806 in Pentonville, died May 8, 1873 in Avignon) engages with the undifferentiated fortune of Bentham. He supplements utilitarianism by differentiating the joys and sorrows of the higher and the lower and adopts the goal of classical philosophy to bring people to perfection and dignity. The pursuit of individual and social happiness is Mill's most important life goal. For this he considers the virtues of nobility especially important.[33] A striking quote from Mill is:

> It is better to be a human being dissatisfied than a pig satisfied; better to be Socrates dissatisfied than a fool satisfied.[34]

He creates a new Millian utilitarianism by restricting the consequences of ethics to the cases where there are no appropriate duties or rules of action (the duties) produce contradictory results. For him, all actions that tend to increase happiness are moral. From this he develops Kant's rules (duties), so that Brandt speaks of a rule-utilitarism[35] or per Smart of a limited utilitarianism. Mill's utilitarianism is therefore added to Kantian duties as a consequence of ethics, if these do not give a clear statement of action.[36] According to Mill, a lie is allowed, contrary to Kant, if, with all its consequences, it produces less harm than the truth.[37] Schopenhauer also contradicts Kant and regards the lie as justified in these circumstances.[38] We know this connection under the concept "emergency or white lie".

[32] See George D. Chryssides, John H. Kaler (1993), An Introduction to Business Ethics Cengage Learning EMEA; 1 edition (November 11, 1993), Boston MA, pp. 125, Joycelyn M. Pollock (2015), Ethical Dilemmas and Decisions in Criminal Justice, 9th ed., Cengage Learning, Inc, Boston MA, pp. 39.

[33] See Mill, John Stuart (1992), p. 89 und 96.

[34] See Mill, John Stuart (1992), p. 89.

[35] See Brandt, Richard B (2003).

[36] See Göbel, Elisabeth (2010), pp. 26 and Smart, John J. C. (1992).

[37] See Mill, John Stuart (2006), Original John Stuart Mill: Utilitarianism, Chapter 2, 1861.

[38] See Schopenhauer, Arthur (1839), p. 264.

Let us take the example of the doctor, who must decide between the mother's life and the child's life, because he loses both. As a doctor and a Christian he can not kill, but non-treatment would otherwise produce worse consequences.[39] The doctor should choose between the life of the mother and the child in the case of birth. There is, however, a duty for the doctor to protect life. To do nothing would be the use a happiness-related worst alternative of action. It remains the choice between the death of the mother or the child. Suppose the mother already has a large family, then the death of the child could lead to less suffering than that of the mother. In the end, this solution is not satisfactory, but there is unfortunately no alternative. Mill's utilitarianism is therefore also generally used for the solution of ethical dilemmas.

The problem with this approach is that the assessment is ultimately left to the individual. Every lie can be justified, you just have to paint the consequences of the truth extremely enough. There are people who are convinced they are a moral person, even though their environment does not agree. A very perfidious example would be the argument of an adulterer who justifies his lies by saying he did not want to hurt his wife. Ultimately, it is concluded that actions with effects on third parties can only be assessed by the third parties themselves. At the very least, objective third parties, as judges, should evaluate. There is, therefore, the basic question of who is to evaluate ethically; the individual or the group or society.

2.1.7 Individual Ethics or Discourse Ethics?

Ethics can also be distinguished from the starting point of the moral evaluation. Does the individual, the public, a society or a public institution assess whether an action is moral? Individual ethics is understood to mean that man is both the object of ethics and the subject who decides on morality. This moral decision-making process is also referred to as monological ethics, in which the individual himself performs the moral evaluation.[40] Classical ethics, such as that of Kant, is an individual ethics. It is about a good life for the individual and the group. In this respect, the consequences of the actions are closely related. The consequences should be positive for the person and for other people. Ethics in this case is a part of practical ethics that aims to provide assistance for the perfection of the individual and the wisdom of a group. The goal here is the happiness of all.

Discourse ethics sees the public as the starting point for moral evaluations. Thus Habermas is of the opinion:

> That only those norms which claim to be the consent of all parties concerned as participants in a practical discourse may apply.[41]

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[39] See Schüller, Bruno (1980), pp. 197.

[40] See Göbel, Elisabeth (2010), pp. 40.

[41] Habermas, Jürgen (1991), p. 12 (authors translation). See as one founder Apel, Karl-Otto (1973).

Habermas, in this sense, favors the principle of unanimity as a societal method of voting, since everyone can prevent a decision they would find damaging by vetoing. This would also create a kind of benefit maximum. The benefit of one person cannot be increased without decreasing the benefit of another. This Pareto efficiency can best be guaranteed by the unanimity rule, since everyone must agree so that no one is at a disadvantage (advantage). Reaching a decision by this procedure will be satisfying because it will only take effect if there is unanimity. It is considered the procedure with the maximum agreement, but there are also disadvantages:

1. The cost of decision-making is high since everyone must agree. It takes a long time to either convince everyone or find an acceptable compromise.
2. Implied veto, so often no decision is made.

Changes made to a decision to the detriment of all parties, but to the advantage of reaching a decision cannot be corrected.

Example: EU Treaty amendments must be approved by all Member States. This means for example, that the Stability Pact can always be loosened as a limit to the EU's debt level, but it can never be tightened because all the countries concerned must agree to this amendment.[42]

3. Strategic reconciliation process:

"Log-rolling" refers to the linking of temporally successive votes so that everyone agrees. Disadvantages, which are why the decision-makers would not agree, are compensated for in other votes: "I give you my vote when I get yours" is the motto. Then there are the so-called "package deals" in which different individual voting points to a co-ordination of votes, so that everyone agrees, because if they want to enforce their advantages they must accept some disadvantages that will be advantages for the other decision makers. With a package-deal agreement, in contrast to a stimulus exchange, the decision-makers are certain that they get their benefits, which makes the individual decisions no longer pareto-efficient, but the package or the sum of all votes.

The problem of unanimous decisions through voice exchange and package deals is that the synergy is lost. The whole is no longer greater than the sum of its parts, since each decision-maker maximizes their own utility, but no longer makes use of the utility of the superordinate organization, e.g. of the EU. One result may be that the individual politician can maximize their advantage, but at the expense of socially suboptimal reconciliation results (unanimity-paradox).[43]

We depend on individual ethics in the community. A drowning person needs the help of others. Therefore, even though individual ethics is extremely immoral, an abandoned aid service is additionally sanctioned by society as discourse ethics.

[42] See also https://www.welt.de/politik/ausland/article13758533/EU-Vertragsaenderung-mit-allen-27-Laendern-gescheitert.html (23.09.2016).

[43] See Conrad, Christian, A. (2003), The Dysfunctions of Unanimity: lessons from the EU steel cri-sis, in: Journal of Common Market Studies, Vol. 41, No. 1, p. 157–169.

Individual ethics is also the starting point for discourse ethics, since the individual ethics of human beings are incorporated into discourse. Collective ethics can also be seen as as a contrast to individual ethics. On the one hand, there is the aspect of control by society, which may be regarded as moral. In the context of public rules, Kant asserts that all actions relating to the rights of other people, with a maxim that is not compatible with public needs, are wrong. On the other hand, the legitimacy of a decision affecting the community makes it necessary for all to have the opportunity to participate in the formation of opinions. This is the basis of a democracy (demos). Public opinion determines the right policy and morality. The public should therefore discuss what it considers to be moral. Habermas and Ulrich are representatives of discourse ethics. However, for an objective opinion formation, Ulrich presupposes that citizens have to be publicly-oriented, enlightened and rational. The representatives of discourse ethics also see that these presuppositions are rarely, if at all, given. Neither are all human beings, and therefore the community, adequately morally informed about the well-being of the community. This is reflected in all the opportunities for participation in modern democracy. Although at the federal level all citizens are directly affected by decisions, the electoral participation is relatively low. At local level, this deficit of participation is even more evident. There will be not only a lack of interest, but also lack of time. The information necessary for the formation of opinion must also be procured and processed by everyone in discourse ethics.

In the modern western democracies, the task of opinion-forming has been taken over the media, and indirectly the control of politics by the public, so that we already speak of the 4th branch of government. Information media like television and the Internet are increasingly replacing newspapers, which leads to fewer resources for investigative journalism. A counterweight could be public television.

Habermas sees the modern media world as a hindrance to forming an objective opinion, since the mass media, and above all television, selects and evaluates information before the citizen can encounter it. They are more manipulative than informative. Discussions on public opinion are increasingly rare. As a solution, Habermas proposes that citizens organize themselves more intensively in internal public spheres, for instance parties, associations and interest groups, in order to have more influence on public opinion.[44]

Without a correlation to the usefulness or well-being of other people, a distinction between good and evil can neither be made in individual ethics nor in discourse ethics. Schopenhauer already saw the basis for selfless and thus moral action in compassion with the fate of others (compassion ethics):

> The truth now expressed, that compassion, as the only non-selfish one, is also the only genuine moral motive …" and "All virtues flow from righteousness and love of mankind …[45]

[44] See Habermas, Jürgen (1975), p. 292.

[45] Schopenhauer, Arthur (1839), p. 270 (author's translation).

> This presupposes, however, that I have certainly identified with the other, and consequently the barrier between myself and non-I, for the moment, is abolished: only then does the matter of the other, its need, its suffering, directly to mine: …[46]

According to Mead, for example, in his approach as a prerequisite for collective moral decisions, the consequences of the decision should be weighed impartially for all parties concerned, and their interests, by taking the decisive role in the role of other stakeholders.[47]

Rawls developed a similar approach. Everyone is to be freed from his interests by moving into a primal state, without social differences, in order to ensure procedural justice. Proceeding from a veil of ignorance, citizens cannot know what destiny is for them. Their abilities, their origin, their health, their wealth, and their environment are unknown to them. They could therefore not represent any interests and put themselves into the role of all concerned and consider whether the norm would affect them in an unbiased manner. This impartiality guarantees that just rules for the state and society will be found. This role identification is to be applied when it comes to the design of institutions and social systems. This is the prerequisite for including all those affected by a decision in order to be able to judge the decision from every point of view. He uses this in order to examine from Hobbes, Lockes, Rousseau, and Kant's theory of the social contract, which results are regarded as just and ethical by all concerned.[48]

Can the group or society in principle evaluate ethically better than the individual? From the approach of discourse ethics one might conclude that a group can better weigh the consequences for third parties or society than a private person affected by the action. From this point of view the victim of an unethical act would not be objective enough. The group or society is legitimized to evaluate actions that affect itself, but it is not per se more ethical than an individual. For example, emotions in the group can mutually reinforce each other and lead to unrational, unethical actions. Unethical social trends can be dominant in society, as in nationalsocialism.[49] Ultimately, in Germany, serious ethical offenses are not left to a jury but to legally trained and ethically qualified judges.

However, the responsibility for group decisions is problematic. In principle, group ethics cannot replace individual ethics. Everyone must also be responsible for themselves and not just the group. Groups can thus even promote unethical behavior if the individual can hide in the group in order to escape the responsibility for unethical behavior. This is always observed in demonstrations. Violent attempts to submerge in the group to avoid prosecution. Criminals are looking for unjust systems to legitimize themselves by the group at the expense of others. Overall, it can be observed that the individual is not responsible for collective decisions. This was also a problem of the socialist or communist central administration economies. As a

[46] Schopenhauer, Arthur (1839), p. 269 (author's translation).

[47] See Mead, George Herbert (1968), p. 301.

[48] See Rawls, John (1979), pp. 158, 341 and in the original Rawls, John (1971), pp. 10, 12, 139.

[49] See also Habermas, Jürgen (1975), p. 279.

consequence, politicians should also be responsible for their individual decisions and not just as a group. Whatever parliament decides, each member must be able to justify his voting behavior.

In order to carry out an ethical assessment, the impact of behavior on the welfare of a third party must be assessed. Where to start?

Without individual ethics, an institutional or collective ethics, a prosperous discourse ethics cannot be created because all individuals pursue their own benefit and do not shrink from manipulating information or having conflicts of interest, in order to achieve their goals at the expense of others in the form of strategic bargaining. Thus, on the one hand, people need the right to vote and to regulate procedures by means of a discourse ethics, to grasp and weigh the views and interests of all parties involved in order to arrive at a morally balanced decision or to carry out a moral evaluation as a collective. In addition, they must first be consensus- and common-minded, and thus also morally oriented, and be able to put themselves into the position of other parties in order to develop a moral reconciliation result. Otherwise, suboptimal horsetrading will result in the enforcement of the stronger group or no decision will be made at all. Wiser heads must prevail by relenting. There must be a willingness to subordinate individual needs to the overall interest of the group. In the case of a discourse, the aim should not be to defend its positions against the arguments of the others, but to measure one's own arguments with those of the others in order to find the best solution. The purpose of the discussions is thus the discovery of truth and not pure self-presentation, as is often observed in talk shows.

Does publicity always produce the truth? Let people discuss their sex-life or stereotypes in public. The publicity will hinder people from saying certain things if they expect negative consequences by the public. On the other hand a public discussion, a discoursive ethic will not always represent the desire and interests of the people.

How can this be applied to practice in companies? Collective decisions are also made in the economy. The board is a group of experts. In this case, the people representing the company are to aggregate information for uniform company decisions. Particularly in the case of risky decisions, for example credit decisions, a tendency has been observed in which as many employees as possible are asked to co-sign. This means that the responsibility for a wrong decision cannot be attributed to a single individual and liability is difficult to achieve. Without responsibility for the consequences, however, the risk of misjudgment increases, as decisions are made too easily or out of self-interest at the expense of the company (moral hazard).

In principle, group decisions are legitimate because all stakeholders have been involved. A supervisor is therefore well advised to present the decision alternatives of the group (the team) and to obtain statements from the affected parties in the case of important decisions affecting his subordinates. If the supervisor takes the decision and responsibility on himself, it will more likely be accepted by those concerned, in particular by those who are negatively affected, because they will at least assume that the supervisor was aware of their position and took it into account when making the decision. Conversely, if the supervisor had decided without the inclusion of the group, he might have turned the group against him. Thus, at least, he could describe his motivations and give the group the feeling of being heard and of their concerns being taking into account. If the group signals that a majority consent to a decision beforehand and their wishes correspond to that of the supervisor, the group is behind the decision, which gives its weight and backing to differing individual opinions.

Finally, the many opinions must be aggregated. Unfortunately, there is no voting procedure that can express the aggregate public opinion in a balanced way. The majority will always dominate the minority. There are also power and information asymmetries in public opinion. Depending on their influence and character, there will always be people who influence public opinion more than others.

What should be taken into account when making a decision? In order to make the right decisions, sufficient information about the effects and the expected results of the decision alternatives with their respective probabilities of occurence (if available) is needed. But is this sufficient to get the best decisions?

In the democratic market economy there are incentives that promote immoral behavior. As a rule, this means there are advantages for companies through competition restrictions. What has so far received very little attention, however, are the decision-making constellations that have a negative impact on society, which is why morality plays an important role. The damage and the injured parties from these decisions are often unknown, which is why they are very problematic. The agent will not suffer the damage caused by his decision. The negative consequences of the decision are borne by others. Take, for example, the inclination of politicians to pay for electoral promises through debt and thus shift the burdens from their electorates to the next generation. The next generation is not yet eligible to vote. The future generation is not involved in the decision-making process. Jurisprudence calls these contracts at the expense of third parties. Such negative decision-externalities arise whenever all the parties affected by the decision are not involved in the decision.

An explanation for the behavior of political decision-makers is provided by Adam Smith,[50] Joseph Alois Schumpeter,[51] and the approach of the "New Political Economy"[52] based on these prophesies. For the politician, this behavior is designed to maximize the votes. According to the approach of the New Political Economy, the politician is not an altruist maximizing the common good, but rather an individual utility maximizer. Political authorities grant these benefits in the form of power, prestige and income. In order to be able to reach the appointed offices, the collection of as many electoral votes as possible - so-called vote maximization - is decisive for the politician. This behavioral orientation can be described as "political rationality" in the sense of political functionality.[53]

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[50] See Starbatty, Joachim (1985), p. 40.

[51] See Schumpeter, Joseph A. (1993), pp. 427.

[52] The behavioral hypotheses of Smith and Schumpeter have taken up Downs in the United States and Herder-Dorneich in Germany, thereby establishing the New Political Economy. See Andel, Norbert (1990), p. 48; Downs, Anthony (1968) and Herder-Dorneich (1957).

[53] A comprehensive theoretical analysis of political ministerial rationality can be found in Frey, Bruno p. (1981). An empirical verification of further parts of the New Political Economy was car-

Corrupting or manipulating lobbying distorts the political decision-making process and does not lead to democratically just decisions, because the advantage of the politician's decisions are gained at the expense of third parties. The parties concerned must be the central principle of decisions. Discourse ethics only works if all concerned can participate in the discourse.

Lobbying influences politicians' decision-making by convincing them that an expenditure is worthwhile for the industry and does so effectively to judge by the existence of such strong lobby representation. The side-effects of politicians and their election campaign donations is also problematic. A politician and the political parties who, like officials, perform sovereign functions should be financially autonomous. If a representative makes a speech, it must be assumed that he does so in the course of his duties and therefore does not need to be paid extra. In the case of business, side jobs can also be approved by the employer both for content and time, due to possible conflicts of interest. Otherwise, lobbyism becomes the gateway of capitalism to undercut democracy. This undemocratic influence can be mitigated by the parties' choice of donor, such as it is in the US. This is where the financial gambler appears as one of the largest campaign candidates. Added to this is the fact that numerous public offices were occupied by former employees, for example, by Goldman Sachs.[54]

How can man be morally controlled, and how is moral behavior supported? Incentive ethics (moral economy) emphasizes rules, the framework of action. A company cannot compete against unethical incentives in the competition. This applies equally to the individual in the company. Individual ethical appeal and postulation are regarded as obsolete and meaningless, so intentions and attitudes are not decisive for action.[55]

Discourse ethics focuses on the ethical process, in which the ethical solution is found through the introduction of many points of view and aspects. In this context the individual appears inappropriate.[56] Discourse ethics, however, only works if individuals can bring their own ethically-based opinion into the discourse and can identify both ethical arguments and consequences. They must also be able to accept the arguments of the others as a whole for a consensus, and to evaluate their ethical meaning in order to come to a priority and ranking of the arguments.

Ultimately, institutional ethics and discourse ethics do not function without individual ethics. National Socialism made it clear that the individual, with reference to the laws, cannot be released from ethical responsibility. No order is comprehensive

ried out by Meyer-Krahmer.See Meyer-Krahmer (1979). The most comprehensive summary of the approaches of the "New Political Economy" is provided by Franke. See Franke, Siegfried F. (1996). A good theoretical analysis of political values can be found Downs, Anthony (1968); Andel, Norbert (1990), pp. 47; Braybrooke, David/ Lindblom, Charles, E. (1963) and Lindblom, Charles, E. (1965).

[54] For example, the former Finance Minister of President Clinton Rubin, as well as Finance Minister Bush's Paulson, came from Goldman Sachs. See Conrad, Christian A. Hrsg. (2015).

[55] See Homann, Karl/Blome-Drees, Franz (1992), p. 18f, 22f, 38 and Pies, Ingo/Blome-Drees, Franz (1993), pp. 177.

[56] See Wittmann, Stephan (1994), pp. 16.

and no system can control people 100%. A total supervisory state would leave no room for individual freedom. This would also be a contradiction to the dignity of man and to his freedom to make self-responsible decisions. People without conscience are an aberration. This is also recognized by the moral economists and encourages the interplay of moral intentions and the institutional stabilization of moral codes of action.[57] An ethically oriented institutional order must provide the incentives for ethical action and serve as an orientation aid when the individual is overwhelmed by choosing between goods because, for example, he can not estimate all the consequences of his actions. Individual morality is the basis for the ethical order, which cannot exist without it. As already stated, individual morality is also needed as a continuous corrective for an ethical order.

Individual ethics is therefore the basis for ethical evaluations and institutional ethics, individual ethics and discourse ethics must work together.

Decisions are always taken by individuals within companies. It is not the companies that can take ethical responsibility, but only the people. A conscience is also required for the ethical weighing of responsibilities. However, the responsibility of the individual must be seen in relation to his or her discretionary competence in the company.

Conclusion
Decisions by politicians may be made at the expense of the company or decisions of managers at the expense of the owner of the company. It is therefore necessary to demand that at least the main interests concerned should be represented in some form in decision making or that the decisions be sanctioned by those concerned, at least in retrospect.

2.2 Modern Ethics

2.2.1 Moral Economics: Morality Must Be Worthwhile

It is precisely this goal conflict between one's own benefit and that of the other that moral economy (or economic theory of morality) addresses. It asserts that if morality is to be achieved, the incentives must be designed to make moral behavior worthwhile.

The main representative and co-founder of moral economy, Karl Homann (born April 9, 1943 in Everswinkel), developed an approach to incentive ethic that tries to direct the individual's development into the morally desired direction using the right incentive design.[58] There is a need for morality to draw up the moral framework.[59]

[57] See Enderle, Georges (1992), p. 15 and Homann, Karl/Blome-Drees, Franz (1992), p. 44.

[58] See Homann, Karl (1999), pp. 330.

[59] See Homann, Karl/Blome-Drees, Franz (1992), pp. 39.

Furthermore, morality is needed because of the incompleteness of the Treaties.[60] In principle, we do not need legislation to create a moral framework even in our legal system. If these are missing, the so-called judicial right can fill these gaps. And in the Anglo-Saxon world, case law opens the possibility of a case-by-case moral evaluation and punishment of trade by the courts.

The advantage, according to their representatives, is that incentive ethics can dispense with moral appeals and blame. People are only required to conform to the law and/or incentive, since they cannot be expected to behave morally to their own disadvantage.

> Actors only follow moral norms in the long run if these observances have individual advantages, or at least no disadvantages, by means of a sequence of actions.[61]

Homann rejects the moral self-control of the individual by means of internalized values because it would be exploited in market competition. If, for example, child labor is not prohibited, an entrepreneur must resort to it because they would otherwise have a competitive disadvantage.

> If a single market participant were required to demand morally justified or intermediate services under competitive conditions, they would be expected to be forced out of the market by their competitors and economically ruined.[62]

The ethical responsibility lies with the government to create the morally correct incentives. Business ethics is thus a pure ordinance or institution ethics.

> Moral and moral motivation of individuals are indispensable, but they are applied in a systematic way in our draft, not in direct economic actions, which in principle are “morally free”, but in the design, in the acceptance and in the observance of the rules for these actions.[63]

A moral framework should be designed in such a way that self-interest becomes socially productive. Homann transfers the utility maximization from Adam Smith to all spheres of life, referring to the economist G. S. Becker.[64]

Homann goes even further. He believes that the social control of moral behavior can no longer be carried out in modern society. People live together in such large numbers that this necessarily leads to anonymity. Social control becomes difficult because contacts are always changing and people are neither dependent on each other, nor know each other. In the past, there was a manageable face-to-face society, but people live in many subcultures at the same time today, not least because of great mobility. He points to the “open society” as per F.A. Hayek and K. Popper. Each individual must create a unique individuality in his life from the options

[60] See Homann, Karl (1999), pp. 330.

[61] Homann, Karl (1999), p. 336 (translation by the author).

[62] Homann, Karl/Blome-Drees, Franz (1992), p. 36 (translation by the author).

[63] Homann, Karl/Blome-Drees, Franz (1992), p. 40.

[64] See Homann, Karl (1999), pp. 335.

available to him, which modern sociology calls increasing individualization.[65] All that remains is the individual with his individual advantage.[66]

> Strive as much as possible according to your own individual advantage - provided that this is also to the advantage of the others, which the general conditions of the economy have to take care of (conditional ethics). The individual striving for advantages thus becomes a moral imperative.[67]

Ulrich criticizes the application of classical ethics to economics with the argument that ethics is corrected "from above" at the expense of economic rationality. He suggests there is a conflict of goals between ethics and economics and fears that ethics will be implemented at the expense of efficiency. He criticizes morality economics, and subordinates the ethics of economic rationality, which he regards as inadequate. For this reason, he proposes the re-integration of ethics into economics with his approach of social-economic rationality (or integrative ethics), so that, as per Aristotle, the goal of profit is once again directed at the higher human goals. The "licentious work of art," that is, profit for itself, must be rejected. Economy is not an end in itself, but is at the service of life, of society, and is to be measured according to its social functional rationality.[68]

This idea is considered counterproductive by other authors with reference to enormous advances in productivity, which are estimated by profit maximization as an incentive effect. Furthermore, they argue that, when compared with antiquity, the production process today is subject to a much higher division of labor and anonymization, which is why it is difficult to view work as the direct vehicle to meet basic needs.[69] Ulrich replies that a morality-free economics develops a self-centered mind. It comes to a purpose-medium-reversal between the world of life and the system. As an example he mentions the need to increase consumption in order to create jobs. This purpose-medium-traffic leads to a loss of meaning in the social system. He demands that the unbounded dynamics of economic rationalization be coupled with practical meanings and values.[70] The fact that there is no conflict between moral demands and economic efficiency in a "socio-economically sound" economy is seen by Göbel as an ideal, but still far from reality.[71]

But what helps me when I get the world and damage my soul? asks the Bible. The question is whether or not maximization of profits as enrichment is directed by

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[65] See Homann, Karl (1999), p. 331. See auch Homann, Karl (2003), pp. 6.

[66] See Homann, Karl (2003), pp. 8, 17. Adam Smith is widely interpreted here in order to help the poor, stand before the election between the caritas and the welfare maximization over the self-interest, and – ethically motivated – has decided for the second.

See Homann, Karl/Blome-Drees, Franz (1992), p. 18.

[67] Homann, Karl/Blome-Drees, Franz (1992), p. 18.

[68] See Ulrich, Peter (2001), p. 11, 97ff, 117; Ulrich, Peter (1989a), pp. 182; Ulrich, Peter (1987), p. 412; Ulrich, Peter (1990); Ulrich, Peter (1980), p. 34; Ulrich, Peter (1989b), p. 10, 15; Göbel, Elisabeth (2010), pp. 79 and Strasser, Gerd J. (1996), p. 286.

[69] See Homann, Karl/Blome-Drees, Franz (1992), pp. 12.

[70] See Ulrich, Peter (1987), p. 415.

[71] See Göbel, Elisabeth (2010), p. 81.

greed and unscrupulousness against the interests of the people. This warning already resonates with Aristotle and is still appropriate. Work no longer being so clearly the means of subsistence has rather increased this problem. What is needed is sustainability, in the sense that people's interests are being met in the economy over the long term.

Moral economics calls on companies to force politics into accepting a different moral order. Mistakes are attributable to false incentives in the market economy, which can be corrected in case of need. An individual moral code is then no longer necessary for the entrepreneur and the manager thanks to Smith's invisible hand, which is praised as a "paradigmatic turning point" in ethics.[72]

Moral economists consider a minimum of individual morality to be indispensable. Finally, the framework conditions or institutions must be morally designed. There are not always laws for behavior. Laws must also be partially interpreted by individuals because they are either not clear or not directly applicable. Thus, companies can behave in accordance with the law and are still regarded as immoral by the company. Here, companies are asked to behave morally beyond the incomplete legal framework. Finally, citizens need to be involved in shaping the framework. They represent the society that also requires individual morality.[73]

The minimalist approach of moral economics is remarkable for its openness. People are not expected to be better than they are. Man is no longer a social being, but a human wolf (homo homini lupus), which seems realistic. The question remains however, whether this approach is sufficient for a well-functioning economy.

If one allows man to be immoral like the moral economy and renounces moral socialization and control of society, one then assumes that there is a state to monitor everything. Not only must the laws cover all moral misconduct, but the state must discover and sanction all unethical acts. This is unrealistic. Even if this were possible, the associated costs and the infringement on privacy would be extreme, and thus not justified. Even the pragmatic Machiavelli himself wrote in the "Discorsi":

> As … legislation is necessary to maintain good mores, good mores are also required for compliance with legislation.[74]

The approach of moral economy is based on the pure individual utility maximization as a behavioral assumption (utilitarianism: homo oeconomicus). Conversely, utility maximization at the expense of others would be justified. There are no virtues, no good sentiments, no consequences for people. Even the duty ethics is limited to the duties that are controlled and sanctioned. There is no responsibility to one's own conscience (moral self-responsibility). The incentive is thus perverted, because why would one still renounce one's own advantage at the expense of third parties? Unethical behavior is thus encouraged by this approach. One's own benefit is maximized at the expense of third parties, wherever rules and supervision allow it, or the disadvantage from the sanctions is less than the benefit derived.

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[72] See Homann, Karl/Blome-Drees, Franz (1992), p. 48.

[73] See Homann, Karl/Blome-Drees, Franz (1992), p. 40, 126, 138, pp. 152 und 159.

[74] See Machiavelli, Nicola (1977), p. 64.

Without institutional regulations, maximization of theft would be achieved by the economic principle of achieving a given goal with minimal effort. In this sense, the moral economy provides an excuse for unethical behavior. If the basic conditions are not sufficient, one is no longer responsible for the unethical behavior; rather, one must behave unethically in order to thrive. This would then also be necessary for the perception of interests for third parties, such as for public organizations, the state or enterprises. A company must behave unethically if the conditions for competition allow it. In the case of globalized markets this would mean that the enterprises of the western industrialized countries would have to orient themselves to the corporate laws and the state framework of the third world. The institutions of the banana republics became the benchmark for corporate ethics, for example. There is an ethical downward adjustment. All in all, the approach of moral economics thus represents a step back for civilization.

The approach of moral economics can be applied to the enterprise level. The employee or manager is not to be held responsible for any immoral behavior if this causes him internal conflict. This means that an employer would have to assume that his or her employee steals from him at every opportunity. Every moral hazard inevitably leads to damage at the expense of the company. The employer could no longer trust that an employee was loyal to him. Such unethical employees would not therefore be hirable by a serious employer because an unethical employee must be under strict control at all times. Apart from the fact that this is neither possible nor affordable to the company, a total monitoring system - with video cameras - is also not allowed in most countries, because it violates human basic rights.

Conclusion

Moral economy posits a causal chain of social change to individualization, yet the reverse can also be inferred. The more individual and anonymous the society the more moral the individual has to be (individual morality), so that social damages are minimized, but the reverse is also true. It is not the order that matters, but how people choose to behave.

2.2.2 Specific Ethical Assessment Principles

2.2.2.1 Human Rights

An economic action is moral or ethical if it does not harm others. The basis for this assessment is the acceptance of the rights of other people and living creatures (including animals). Though the ideas orginiate from the Enlightenment, human rights were formulated for the first time in the American Virginia Bill of Rights in 1776 and then in the French Declaration of Human Rights in 1789.[75] These rights are thus internationally legitimated and interested or affected parties can demand

[75] See Maier, Hans (1997), p. 16ff.

their implementation. Man is attributed special dignity because he is the only living creature with his own free moral judgment, and can be protective of one another. Kant formulated the practical imperative for this reason.

> Act that you need mankind, both in your person and in the person of each other, at any time at the same time as an end, never merely as a means.[76]

Many human rights have been formulated. The most well-known is the "Universal Declaration of Human Rights" of the General Assembly of the United Nations of 10 December 1948, the so-called UN Declaration of Human Rights. Particular mention should be made of the following:

- The freedom of individuals, such as a sphere of personal freedom, free choice of residence, freedom of conscience and religion, freedom of expression and freedom of information (press freedom), free choice of education and occupation, etc.
- Fair values, such as the prohibition of discrimination, entitlement to equality before the law, equal pay for equal work, equal suffrage, etc.
- Good living conditions, such as the prohibition of torture, social protection of a dignified existence, protection from degrading treatment.

The formulation of human rights is at least partly due to a tendency towards individualization. Karl Marx was an opponent of the human rights movement. He saw the rights of society threatened by human rights. Already here, the contrast between the necessity of the individual and the collective showed itself to be subordinated to the desire for individual development. Thus, Marx says: "None of the so-called human rights go beyond the egoistic man, the man, as he is a member of bourgeois society, namely an individual, withdrawn into his private interest and his private will, separated from the community. Far from the fact that man was conceived of as a part of them, the life of nature itself, society, appears as a framework external to the individual, a limitation of its original independence. The only bond that binds individuals is the need for nature, the need for private interest, the preservation of their property and their selfish person."[77]

The individual concept of freedom was dismissed as a bourgeois invention in the countries of real socialism. Instead, so-called basic social rights were expressed; the right to work, the right to vocational training and social protection. However, the individual was left with no decision-making freedom and his life was planned centrally.[78]

From the rights, however, come indirect obligations for how people are to deal with each other. People must recognize the rights of the others as equal in principle, and even accept a restriction of their own rights, if it is the only way for the rights

[76] See Kant, Immanuel (1797a), (C), p. 429.

[77] Max, Karl (1843).

[78] See Maier, Hans (1997), pp. 40.

and freedom of others or general welfare to be guaranteed. And finally, there is a duty to work for the realization of human rights.[79]

There is now a new category of human rights given to people. These include the right to peace, cultural diversity and the right to development.[80]

2.2.2.2 Environmental Protection as Sustainability

The economist John Stuart Mill already recognized the environment as a valuable asset.[81] Environmental protection is another criterion for the ethical assessment of economic activities. The resources of our environment are to be maintained not only in the short term for the present generation, but also in the long term for future generations. Today's human being assumes the responsibility for the fact that the natural basis of life must also be available to future generations. Sustainability can therefore be traced back to human rights if the same rights for the use of nature are assumed for current and future generations.

The environment represents both: the basis for future production as well as the well-being or quality of life for people. The air, the seas, and the forests are examples of such environmental goods. Sustainability is economic behavior that leads to no long-term worsening of the economic conditions (definition of sustainability).[82]

2.2.2.3 Animal Protection

Since animals can suffer as living creatures, they are also protected. Accordingly, the use of animals by humans must also be counterbalanced and weighed. Kant already advocates a balancing in animal experiments and rejects these if alternative methods can be used to carry out tests.[83] Biodiversity is not only the basis for future economic use by humans, but also offers people a sense of life.[84]

2.2.3 Justice as an Assessment and Behavioral Approach

Justice is actually a classical ethical approach and its roots can be found in the work of Aristotle. This approach is not usually included in the appraisal approaches however is needed for assessing human behavior, which is why it is to be supplemented here in a more modern form.

[79] See Maier, Hans (1997), pp. 95; www.un.org/depts/german/menschenrechte/aemr.pdf and Göbel, Elisabeth (2010), pp. 147.

[80] See Hilpert (1991)

[81] See Mill, John Stuart (1848), pp. 62.

[82] See Göbel, Elisabeth (2010), pp. 150.

[83] See Kant, Immanuel (1797a), A108 and Kant, Immanuel (1793).

[84] See Weinschenck, Günther/Dabbert, Stephan (1999), pp. 560 and Teutsch, Gotthard M. (1995).

The perfect virtue for Aristotle is justice, which serves as a measure of the economy. He does not understand any need for distribution according to need, as is the case with socialism, but rather distribution according to status.

> If these are not equal, they are not the same; but controversy and accusation spring from it, if either those who are equal, not the same, or those who are not equal, attain and enjoy the like.[85]

According to Aristotle, there must also be a balancing justice, which compensates for unlawful distributive results, such as from fraud.[86] The equality principle of human beings is a basic principle of democracy and ethics.

We understand justice (or fairness) to be a behavior that results in a distribution of benefit or harm among people, which takes into account the differences and rights of those affected by the distribution (**definition**). "Just" and "ethical" are related terms insofar as they refer to to the effects of actions on third parties. An action that is classified as justified can also have negative effects on third parties and thus be unethical in the narrow sense.

When it comes to the question of whether a behavior is justified, it is primarily about the weighing of interests. We also speak of the legitimacy of behavior. There are many different definitions of justice. An action is considered fair when no one is favored or disadvantaged by the behavior, assuming that all persons concerned are equally entitled. No one is allowed to have more or less harm than another. The effect of an action must be the same for all. If the persons concerned are unequal in an aspect important for the action, this must be taken into account. According to Aristotle, unequal treatment is appropriate for unequal performance. For example, the remuneration of employees is limited by their performance, responsibility and qualifications. This also results in a salary inequality. Those who do more carry more responsibility and are more highly qualified, get more than an equal share.

We need justice to balance interests. In principle, we have defined ethical with regard to the effect of behavior on third parties. However, the actor is not required to take his own welfare into account.[87] This would be unjust because the actor is, in principle, equal with all others. For example, a person cannot be required to work hard for his salary and then give half the salary to someone who has done nothing. Here one would cite the case of Aristotle, that in the sense of justice unequals should be given unequal shares.

In this behavioral approach there is also a motivation for the agent. Many people want to be fair and demand justice. However, the determination of just behavior is difficult for the individual because he cannot assess the effect of an action on third parties and often subjectively tends to favor himself. The just distribution of benefit and damage can usually only be determined from the outside, through uninvolved and thus objective third parties. Nevertheless, this assessment makes sense because

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[85] Aristoteles (1960), p. 204.

[86] See Aristoteles (1960), p. 196 und p. 358; Aristoteles (1991), pp. 22 or 1257b und 1258b and Schefold, Bertram (1989), p. 19–55.

[87] So also Kant in his practical imperative. Kant, Immanuel (1797a), (C), p. 429.

an action can be ethical if it has a positive effect on all concerned, but is still unjust. Such an act would also be classified as ethical according to our previous evaluation criteria, but we could not differentiate further. Different actions can be ethical, but only one can be just.

The discourse ethics presented in Sect. 2.1.7. helps in the determination of equitable behavior by giving all participants the opportunity to present their own position and to put themselves in the respective situation of others involved.

2.3 Conclusion on Ethical Evaluation Procedures

Let us summarize by saying that all the ethics concepts presented have their strengths and weaknesses. The duty ethics in pure form would be the simplest form. In this ethical conception, man has only to adhere to the rules of conduct to be moral. He can follow instructions without worrying about their implications. This corresponds to the observance of the rules of conduct given by religions and ideologies or laws. These are norms with and without penalty. Ultimately, we must answer the question of why people should behave morally at all. However, there are many people who do not have the moral and intellectual prerequisites to recognize or even weigh the consequences of their actions on themselves and others. Also not all people have a good disposition. There are two other problems that remain unresolved in the subject of duty ethics. There are decision-making situations for which there are no rules and decision-making alternatives might all be unethical. In these situations duty ethics is not enough and man has to weigh the various consequences. In order to be moral when weighing the consequences, he must have a good disposition, that is, an ethic of conviction. In the borderline situations described above, all ethical forms must be consulted in order to arrive at a morally balanced decision.

The general question of whether an action can be moral without a good attitude must still be addressed. The clear answer of the philosophers Kant and Hegel is "no" and our understanding of justice would also consider it unjust to praise someone as moral if the good effect of an act was accidental and unintended. On the contrary, the greater the personal sacrifice to do good to others, the behavior is seen as moral by society. A good attitude and the knowledge of the consequences of the action also allow a morally balanced action without rules (duties).

According to Kant, an ethical action is less valuable when there is no sacrifice on the part of the individual. If the agent has an advantage from the action, the moral aspect of the action, is mixed with his own benefit. The decision-making process is no longer purely moral. Conversely, one has to ask how the action is to be judged if one's own advantage was not decisive, but the motive to help others. Ad absurdum, an action may be less moral only because it is a pleasure for the person to allow others to benefit from the action. The value of the help would be diminished in this way by the fact that the actor does not feel loss, but joy.

The problem is that convictions are rarely recognizable from the outside, making them only a conscience orientation for the actor and not a generally valid assessment criterion. Socially, no one notices sentiment, and it seems silly to put sentiment in the foreground because an immoral liar would claim moral sentiments even without feeling them. “Do good and talk about it” is therefore not bad advice.

If an action or behavioral pattern is to be assessed, Bentham and Mill provide a plausible approach. What else should be used for the purpose of evaluation besides the benefit or happiness or joy and suffering? The subjective appreciation of pleasures and suffering remains a problem, since it is difficult to assess the actions and their effects on third parties. Even interpersonal allocation is absolutely necessary in a society, because it is not right for everyone. There are always benefits and disadvantaged from an action. It is important that there are limits to the reasonableness of actions. Violations of health and human dignity must not be weighed against monetary benefits.

2.4 Application Examples

Group Work: Lying on an Application?
The general ethical appraisal approaches result in different rules for action. Can I lie about my abilities in my interview? Discuss this question in groups and try to apply the different ethical approaches (constitutional ethics, categorical imperative, publicity rule, practical imperative, duty ethics, ethics of responsibility and moral economics).

Solution
The ethical evaluation could be as follows (with a large margin for different values):

1. Constitutional ethics: I am better than the others and like helping the company.
2. Reason balancing:
   (A) Categorical imperative: Law: Everyone lying would be a catastrophe: No! Do I want to be lied to myself? No!
   (B) Publicity rules: The rights of the employer have been violated. He was deceived and will not agree with the behavior: No!
   (C) Practical Imperative: No, I do not use the employer as a means for the purpose. I do harm to him by fraud.
3. Duty ethics (deontological ethics): No, lies are never allowed.
4. Ethics of responsibility (teleological ethics): If I lie, I do harm to my employer and other competitors, but if I do not get a job, my fate is much worse.
5. Moral Economics: There is no sufficient state regulation that reveals and punishes lies in applications, so everyone is forced to lie.

What is the right answer to the question? Due to the asymmetric distribution of information at the expense of the employer, it is difficult for the HR manager to uncover lies or false information in the application process. It is therefore a good

Table 2.1 Ethical valuation approaches

Ethical valuation approaches	Criteria to judge behavior
Ethic of conviction	Will; creates a good for others
Categorical imperative	Does general applicability create a good for others?
	Is it what one would want for themselves?
Practical imperative	Positive effect on others
Publicity rule	Reaction of those affected and society
Ethics of duties	Obeying rules and the corresponding norms
Ethics of responsibility	Positive effects
Utilitarism	Positive net happiness when happiness is balanced against suffering
Moral Economics	Are social moral rules sufficient? Does it pay to act morally?
Criteria of justice	Distribution of effects according to the relevant criteria

idea not to be too modest. In order not to spoil the hiring opportunities, the applicant should not take the standard question “What are their greatest weaknesses” literally. Here, the moral economy is approached. There is a veil of not knowing. A job interview is about selling your own work to the employer. In this respect, the applicant must convince the employer of their good qualities. This is a sales pitch. The employers also expect aggrandizement. As with a sales talk, however, there is also product liability, as with a job interview. You must not promise properties that the product, in this case yourself as an employee, cannot fulfill in the company afterwards. Lying is not allowed and lies here have also short legs. A company is usually quick to find out what an employee can do.

After studying the different forms of ethics, we will review our definition of “moral” or “ethical”. An ethics of responsibility always examines the effects of an action on third parties to determine morality. Even in the case of Kant, reason should make clear the effects on third parties. In this respect he assumes a good disposition, a conviction of morality from the actor. Our definition of human behavior as ethical or moral, that is, as “good,” when no one is harmed, corresponds to this reasoning. An action is good when it increases wellbeing, and benefits other people, or at least does not do harm (Table 2.1).

2.5 Summary

In principle, the ethical evaluation criteria are available to executives in order to assess and weigh their action alternatives. Moral economics is inadequate as the only decision criterion, since it accepts immoral consequences for third parties. Many people do not have the moral and intellectual prerequisites to recognize or even weigh the consequences of their actions on themselves and others. Even the conviction to do good is absent in many people. Here duty ethics is more effective.

There are two essential problems that remain unsolved in the case of duty ethics, however. On the one hand there are decision-making situations for which there are no rules, or which only contain unethical alternatives. In these situations duty ethics is not enough and man has to weigh the consequences. In order to be moral when weighing the consequences, he must have a disposition to want to do good, which is constitutional ethics. In the borderline situations described above, all ethical forms must be consulted in order to arrive at a morally balanced decision. On the other hand, the general question remains as to whether an action can be ethical without good intention.

Comprehension Questions

1. What are the categorical and practical imperatives of Kant? Give us some examples from the business world.
2. Define values and duties.
3. Which assessment approach corresponds to your personal behavioral goal? To what extent do you think you can keep this type of behavior in the business?

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Chapter 3
The Image of Humans

What Follows Why?
The following chapter analyzes human behavior in the economy. What motivates people, what goals do they pursue and what makes them happy? We need the insights gained to explain unethical behavior and to move people to ethical behavior.

Learning Goals
You should be able to describe the fundamentals of human behavior in your own words.

3.1 The Classical View of Man: Homo Economicus

Economics uses a simplified model of humanity to represent economic actors, namely homo economicus, an egoistic creature.[1] According to F. A. Hayek the term homo economicus goes back to John Stuart Mill[2] and Utilitarianism.[3] Homo economicus is like a computer, or a being that only acts rationally (principle of rationality) as a machine would. This ideal actor is attributed preferences, and thus a constant utility function. Such assumptions have the advantage that human behavior would change only if the basic parameters for a decision changed.[4] Assuming a

[1] Weber explains the reduction to rational goal-oriented action as simplified behavioral assumptions by giving examples of exceptions to rational behavior, such as stock market panic. See Weber, Max (1922), p. 16.

[2] "It is concerned with him solely as a being who desires to possess wealth, and who is capable of judging of the comparative efficacy of means for obtaining that end. It predicts only such of the phenomena of the social state as take place in consequence of the pursuit of wealth. It makes entire abstraction of every other human passion or motive;" Mill, John Stuart (1844), See p. 38.

[3] See Hayek, F. A. (1971), p. 77.

[4] See Franz, Stephan (2004) and Göbel, Elisabeth (2010), p. 52.

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given degree of information, they would always choose the option that maximizes their gain (principle of the individual), making their decisions mathematically predictable.[5] On the other hand, it means that homo economicus not only leaves the benefit to others out of the equation but that he would even commit amoral acts to achieve his goal of maximizing his own advantage, including lying, betraying and other immoral acts.[6]

The theoretical homo economicus is a shallow image. When societal influences are not part of the equation, such an actor is represented as being purely psychological, not sociological. Mill considered people sociological, however.[7] If we take societal mores for human behavior into consideration, the resulting decisions change. These mores are societal norms that dictate to the members of a society how they should act in order to benefit the society and not harm it. Societal norms and values can be chosen consciously by the individuals or inculcated socially. Societal sanctions in the case of norm infractions can make certain decision alternatives seem to be more utility maximizing even if they bring fewer individuals more advantage than others.[8] The term gain is to be understood as net individual advantage, in other words profitable gain reduced by losses from social sanctions. On the flip side, sanctions prevent decision alternatives that would maximize the individual's gain at the cost of society. Sociology refers to motive/norm conflicts in this context, because an individual's need conflicts with the norm. Societal norms have rarely been taken into consideration by economic science, if at all.

The same is true for ethical values, although the term "gain" applies even less. The need that many people feel to do good for other people only indirectly provides a gain, by satisfying an existing subjective need. Everything that a person wants and gets could be described as a gain,[9] but additional benefit must also be objectively comprehensible to a third party. The fairy tale "Hans in Luck" by the Grimm Brothers[10] illustrated how a person can feel better subjectively, even though their objective gain has diminished. The term "gain" in this context is really too restrictive,

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[5] See Erlei, Mathias/Leschke, Martin/Sauerland, Dirk (1999), pp. 2. Current economic thinking handles market failure as a human failure only marginally, if it means rejecting the Rationality Theory of homo-oeconomicus. But even then human behavior is deterministic based on the assumptions of how they behave irrationally.

[6] See Milgrom, Roberts (1992).

[7] "The deeply rooted conception which every individual even now has of himself as a social being, tends to make him feel it one of his natural wants that there should be harmony between his feelings and aims and those of his fellow creatures. If differences of opinion and of mental culture make it impossible for him to share many of their actual feelings- perhaps make him denounce and defy those feelings- he still needs to be conscious that his real aim and theirs do not conflict; that he is not opposing himself to what they really wish for, namely their own good, but is, on the contrary, promoting it. This feeling in most individuals is much inferior in strength to their selfish feelings, and is often wanting altogether. But to those who have it, it possesses all the characters of a natural feeling." Mill, John Stuart (1863), pp. 267.

[8] See Föhr, Silvia/Lenz, Hansrudi (1992), p. 153.

[9] See Hausmann, Daniel M./McPherson, Michael (2006), pp. 79.

[10] See http://www.authorama.com/grimms-fairy-tales-2.html

as one can really only speak of fulfilling a need. Economic decision-making theory needs to be expanded to include this concept. To sacrifice something for others may be rare, but it is a very well-known human phenomenon. To sacrifice would then indicate following the dictates of a need to help others, even if it reduces one's own objective advantage. This is exactly what earns our admiration and what many religions, including Christianity, demand of people; "It is better to give than to receive." The moral of the fairy tale is that Hans minimizes his objective gain and maximizes his subjective benefit, or better his happiness. We need to speak more generally of happiness maximization when examining human motivations. The idea that having goods from the economy alone does not bring happiness is clear once goods have been acquired. That happy feeling does not usually last very long, and in the end the goods only fulfill material needs.

Jeremy Bentham, James Mill and his son John Stuart Mill, the main founders of Utilitarianism, grew apart over time. Utility maximization is now understood exclusively in relation to material gain. Happiness is closer to Bentham's thinking, as he considered pain and pleasure.[11] For Bentham, happiness could arise from things such as sensory pleasure, a good reputation, wealth, power, or charitableness, but also negatively connoted traits such as malevolence. Pain might result from privation, a bad reputation, enemies, but potentially also from charitableness, piety or malevolence. John Stuart Mill includes not only desire in the pursuit of happiness but also the pursuit of honor, duty, and morality. Whoever rejects Utilitarianism because they reject the pursuit of happiness underestimates humanity. People search for happiness through their desires, but also through dignity.[12] A person's self interest, thus the basis for being happy, can be found in the pleasure derived from understanding and morality. According to Mill, there are moral and immoral pleasures or perceptions of happiness, which is why people must question their interests and adjust their motives to their ethical views.[13] Utility maximization must therefore be understood as pleasure maximization and not solely as the maximization of material gain.

As opposed to the economic theory of homo economicus the information processor, social psychology considers people to be decision-making problem simplifiers.

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[11] "Nature has placed mankind under the governance of two sovereign masters, pain and pleasure. It is for them alone to point out what we ought to do, as well as to determine what we shall do. On the one hand the standard of right and wrong, on the other the chain of causes and effects, are fastened to their throne. They govern us in all we do, in all we say, in all we think: every effort we can make to throw off our subjection, will serve but to demonstrate and confirm it. In words a man may pretend to abjure their empire: but in reality he will remain subject to it all the while. The principle of utility recognizes this subjection, and assumes it for the foundation of that system, the object of which is to rear the fabric of felicity by the hands of reason and of law." Bentham, Jeremy (1789), first chapter.

[12] "… but its most appropriate appellation is a sense of dignity, which all human beings possess in one form or other, and in some, though by no means in exact, proportion to their higher faculties, and which is so essential a part of the happiness of those in whom it is strong…" Mill, John Stuart (1863), p. 10. See Mill, John Stuart (1992), pp. 86.

[13] See Mill, John Stuart (1992), pp. 86 and 90.

To this end people use patterns, created from their impressions and experiences. Social psychology has used several interesting experiments to show the influence of patterns. Pre-determined thought structures and ways to solve problems (behaviors) help to call up patterns and information quickly. Over-confidence can also be an issue with thinking. It has been shown that people do not have the abilities of a homo economicus.[14] New Behavioral Finance agrees.[15]

According to social psychology, cultural/societal influences form human behavior, which deviates from the homo economicus stereotype. Examples include various gestures and the strongly self-centered Western cultures as opposed to Asian cultures. It is also important to know how people adapt to cognitive dissonance, which might be created by an immoral environment. The Ash Conformity Experiment proved that individuals even adopt a false group opinion if the group presents its view with self-confidence. We humans therefore tend to over evaluate the way something is being presented. This also explains why managers who are so self-confident that they do not question themselves and never admit mistakes are more successful than those that correct themselves. However, this also results in more mistakes.

People take on roles within groups that influence their behavior. Individuals adapt to the group in order to gain social recognition (social comparison process or aspiring to conformity). It is assumed on the other hand, that only the individual influences the behavior of homo economicus. Norms create moral behavior, as has been shown in experiments.[16]

The simplified human model of homo economicus is legitimate. Rational, informed and balanced action generally does bring advantages. The assumptions behind homo economicus become problematic when economic science forgets that they are dealing with a model[17] and treat it as reality.[18]

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[14] See Jonas K./Stroebe, W./Hewstone M. (2007), pp. 374; Fehr, Ernst/Fischbacher, Urs (2003), p. 786 and Fehr, Ernst/Gächter, Simon/Fischbacher, Urs (2001); Frank, Robert H. (2004); Frank, Robert H. (1988) and Gürerk, Özgür/Irlenbusch, Bernd/Rockenbach, Bettina (2006).

[15] See Conrad, Christian A. (2005), pp. 391.

[16] See Jonas K./Stroebe, W./Hewstone M. (2007), pp. 374; Fehr, Ernst/Fischbacher, Urs (2003), p. 786 and Fehr, Ernst/Gächter, Simon/Fischbacher, Urs (2001); Frank, Robert H. (2004); Frank, Robert H. (1988) and Gürerk, Özgür/Irlenbusch, Bernd/Rockenbach, Bettina (2006).

[17] "Not that any political economist was ever so absurd as to suppose that mankind are really thus constituted, but because this is the mode in which science must necessarily proceed." Mill, John Stuart (1844), V 38.

[18] An interesting neurological experiment was conducted in 2003 that showed *homo-economicus* to be a fiction, and the press gave its conclusions much attention. The ultimatum game was conducted in the laboratory of Princeton University by Alan Sanfeys. See Sanfey, Alan et al. (2002) and Handelsblatt vom 03/23/06, p. 11.

3.2 Falsely Understood Egoism

Perhaps the lack of ethics and morals of many managers comes from a false understanding of the economic bible "Wealth of Nations," by Adam Smith, or at least a very abbreviated and thus misleading representation of his ideas as presented in economic education. The brilliant idea of Adam Smith was how human self-interest is directed toward the common good through the "invisible hand" of the market. Even bad people thus serve the common good, as Hume commented. The law of the market functions as an ethical guideline thus[19]:

> …it is not from the benevolence of the butcher, the brewer, or the baker, that we expect our dinner, but from their regard to their own interest.[20]
>
> By pursuing his own interest he frequently promotes that of the society more effectually than when he really intends to promote it.[21]

It almost seems as though many managers take this as a free pass to limitless pursuit of their own interest, as though they understood it as egoism at the cost of others. The second central work of the Scottish moral philosopher Adam Smith, "Theory of Moral Sentiments" is almost never mentioned. Here we find quite different quotes:

> How selfish soever man may be supposed, there are evidently some principles in his nature, which interest him in the fortune of others, and render their happiness necessary to him, though he derives nothing from it except the pleasure of seeing it.[22]

According to Smith, people have a highly developed conscience that functions as an internal moral judge. Like Schopenhauer and Hume,[23] he accords people the capacity of compassion and sympathy with other people. They can empathize with the interests and needs of their fellow humans, and must therefore weigh them in their conscience against their own self-interest. They are helped in this by an imaginary, objective third-person opinion derived from the question of how an impartial third party would decide. The principle of rational thinking is the basis for weighing the various interests. This capacity of a human conscience is generally credited to God or generally to human rationality. The individual is part of the natural whole and responsible for his or her own decisions. Responsibility and freedom are natural

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[19] See Starbatty, Joachim (1999), pp. 17.

[20] Smith, Adam (1776), Paragraph I, p. 82. The idea of an invisible hand can be traced back to Mandevilles bee fable. "The worst of all the Multitude Did something for the Common Good." Mandeville, Bernard de (1732) p. 9. Mandeville had already seen the danger than self-interest can pose to society: "So vice is beneficial found, when it's by justice lopt, and bound; Nay the people would be great; as necessary to the state; As hunger is to make them eat; Bare virtue can't make nations live; In Splendor; they, that would revive A Golden Age must be as free For Acorns, as for Honesty." Mandeville, Bernard de (1732) p. 24

[21] Smith, Adam (1776), Book IV, Chapter II, p. 489.

[22] Smith Adam (1759), Part I, Chapter I.

[23] "We are certain, that sympathy is a very powerful principal in human nature." Hume, David (1739), p. 667. See Schopenhauer, Arthur (1840), § 15–18.

and God-given. Smith believes a truly uninvolved and objective third party's opinion is necessary to determine whether an action is morally and ethically acceptable. This impartial observer takes on the task of social corrective, which is comparable to Immanuel Kant's categorical imperative. Always act in such a way, that the basis for decisions could be the principle behind a general rule, the behavior could always be acted upon by all people and for the good of society.[24]

Adam Smith was aware that the invisible hand is not sufficient to protect the common good from damage done by an individual. He stressed the need for an economic and structural system that included protection for the common good. Enrichment of the individual at the expense of the common good cannot be tolerated by a society for various reasons. Besides the damage sustained by the national economy, such behavior supplants the system. According to Smith, trade can develop via markets to the benefit of all people, thus creating wealth, only when the legal system is functional and there is trust in the supremacy of the state.[25]

3.3 Individualism Versus Collectivism

3.3.1 Rolegame Individualism Versus Collectivism

Each participant gets 7 clothespins. The goal is to attach as many clothespins as possible to the other participants. After 30 s play stops and clothespins are counted. Round 2 follows with the aim of removing as many clothespins as possible from the others. The participants fight for the clothespins. After 30 s again play is stopped and clothespins counted. The game host now asks the participants why they fought against each other. He never said anything about competition. Through cooperation, they would have progressed much further (The game was explained in a talk by Dirk von Vopelius at the IHK in Nuremberg on June 10th 2015).

Social morality, or better ethos, as moral behavior in practice, is a public good in economic terms. The benefits of cooperative, considerate, and polite behavior of a society benefit all who are a part of it. The benefit is arbitrarily divisible, so not rival, and no one can be excluded. This also applies to teamwork. There is a free-rider problem, however. There is an incentive not to participate in the group performance because one cannot be excluded from the group's success.

Rational utility maximization, however, does not necessarily mean harm to third parties. For example, in game theory multi-round games show that decision-makers learn from their decisions and take into account the other's harmful counter-reaction, which is why they no longer maximize their usefulness in the short term. From a game theory point of view, games over several rounds have shown behavior to be profit-maximizing if one behaves first cooperatively and only if the other does not

[24] See Nass, Elmar (2003), p. 47.

[25] See Smith, Adam (1776), chapter III, first paragraph.

cooperate, to counter this with a likewise uncooperative behavior (trigger or tit-for-tat strategy).

The trigger or tit-for-tat games describe the underlying conflict between individual and collective rationality. In the prisoner's dilemma, maximizing individual utility at the cost of third parties is in direct opposition to collective benefit through social gains, e.g. access to collective goods such as a clean environment. In the Sixties, Anatol Rapoport and Albert Chammah used experiments to show that cooperation begins if games such as the prisoner's dilemma are played repeatedly. Based on computer simulations, Robert Axelrod later analyzed the conditions under which cooperation comes into being. In this context the tit-for-tat strategy suggested by Rapoport maximized results. This strategy has its strengths and weaknesses. The strategy says to play fair and never fleece or injure your opponent. Only if your opponent behaves uncooperatively, should you do the same. This strategy maintains the possibility for opponents to gain more only as long as they behave cooperatively, and to gain less if they are uncooperative. The motivation is thus to be cooperative and receive sanctions if you are not. The regulated sanctions would be the norms of the game. Exploitative strategies harm one's self and the other, because the gains from cooperation disappear. In the end, maximizing individual gain at the cost of another party means less net utility. Rapoport calls the principle behind this strategy "in weakness is strength," and recommends it as a leitmotif in his studies on arms races and conflict avoidance.[26] But this is only true for smaller groups. The more players are in the game the less they can see the connection between their (un-) cooperative behaviour and the reaction of the others.

The issue of cooperation benefits from public goods can also be illustrated with a game. A **public goods game** consists of say 5 people who must each pay 10$ into a pot. If everyone pays in, the money in the pot doubles, which is meant to represent the added value of public goods. If not everyone pays in, the public good is not created and the sum is divided by five and paid back out. In the worst case scenario a player could pay in 10$ and get back 2$.

Game 1 Public Goods Game

Play the public goods game with chewing gum.

Give at least three people 2 pieces of chewing gum each. Tell them if they all put the chewing gum in a pot or in a cap below the table then you will give them an additional chewing gum each. If there are not two from each person in the pot all the chewing gum is distributed equally between the players.

The experiment shows that in the case of public goods made available, the initial trust decreases over several rounds of play because of the free-rider issue.[27] The player does not know how the others behave. Best case: he does not pay but he gets 1.3 pieces of chewing gum (3 players) and does not risk anything. Worst case: he gives 2 pieces and all others do not, then he gets 0.30 pieces back.

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[26] See Rapoport, Anatol /Chammah, Albert M. (1970); Axelrod, Robert (1987) and Schwaninger, Markus (2008).

[27] See Holzmann, Robert (2015), p. 131.

In a public goods game, 40–60% of players are cooperative at the beginning. This behavior decreases when they notice that they are hurting themselves and the cooperative good is not being created. They then play up to ten rounds of anonymous play cooperatively and then become uncooperative.[28] There is always a base group of players who insist on being uncooperative and try to maximize their gain to the detriment of the other players. These free riders make up about one third of players. Altruistic rewards and punishments, which are also at the cost of the participants, can discipline the free riders into more cooperative behavior, which can allow the public good to be created to everyone's benefit.[29]

Fehr, Fischbacher, Gürerk et al. emphasize the role of so-called "strong reciprocators," meaning players that punish uncooperative free riders even though it is to their detriment.[30] Emotions motivate the strong reciprocators to set the norms despite the loss they may suffer. Altruistic sanctioning of uncooperative behavior can be motivated by gratefulness, or a desire for retaliation. Without emotions no one would punish another to their own detriment. Getting upset over uncooperative behavior creates a sense of gratification and thus a net benefit for inflicting the punishment, which makes altruistic punishments possible.[31] Fehr and Fischbacher showed that over 60% of neutral third parties will intervene in the case of game behavior perceived as unfair and uncooperative to impose fairness and cooperation even if it puts them at a disadvantage.[32] We are talking about the sense of justice that makes us human. The sense of justice is why cooperative behavior in a group gets enforced. There are sanctions meted out, even though doing so requires effort and the sense of justice unites the group in its behavior.

These games also show the importance of societal sanctions (norms) and learning/socialization. The great majority of players enter the game in a spirit of cooperation, but they are willing to change that behavior if the advantages of cooperating turn to disadvantages. Such an experience is also part of the learning process, such as the role that reputation plays. If there is an option to switch to a game where sanctions are possible, it will be taken in order enjoy public goods. With time the players are able to establish norms, allowing punishments to diminish greatly.[33] The tit-for-tat strategy was observed during these games as well. Thus most players saw their cooperative contribution increase along with that of the other players.[34]

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[28] See Fehr, Ernst/Fischbacher, Urs (2003), p. 786.

[29] See Fehr, Ernst/Fischbacher, Urs (2003), p. 786 and Fehr, Ernst/Gächter, Simon/Fischbacher, Urs (2001).

[30] "Strong reciprocators bear the cost of rewarding or punishing even if they gain no individual economic benefit whatsoever from their acts." Fehr, Ernst/Fischbacher, Urs (2003), p. 785. See Gürerk, Özgür/Irlenbusch, Bernd/Rockenbach, Bettina (2006).

[31] See Föhr, Silvia/Lenz, Hansrudi (1992), pp. 153 and Frank, Robert H. (1988) and Frank, Robert H. (2004).

[32] See Fehr, Ernst/Fischbacher, Urs (2003).

[33] See Fehr, Ernst/Fischbacher, Urs (2003).

[34] See Falk, Armin (2003), p. 147 and Fehr, Ernst/Gächter, Simon/Fischbacher, Urs (2001).

It maximizes one's advantage to be uncooperative when playing just one round of the game, yet cooperative if playing several rounds. In other words, if the other players can neither defend themselves nor retaliate it is advantageous to fleece one's opponents, behaving unethically to the detriment of others, but not if they are able to defend their interests.

It is therefore not surprising that many ethical misdeeds have taken place within the finance sector within the last few years, since the games are generally played with just one round. No one even knows their business partner on the stock market. The bad subprime credits were mostly sold through the stock markets. If the buyer could have prosecuted the seller, the worthless sales would never have reached such a level because it would not have maximized utility to do so. Anywhere there is a long-term business relationship, or legal damage compensation is easy to obtain, it is not utility maximizing to injure a business partner.

We can observe however, that business is sometimes conducted such that this utility-maximizing strategy is contradicted. There are fields of u-pick flowers, and self-serve newspaper kiosks in the city, where one can cut flowers or take a paper without paying for it. Not paying would be the rational utility maximization strategy, since the "buyer" would not fear any reprisal. These offers exist nonetheless, which means that many people behave ethically and socially, instead of rationally utility-maximizing.

There have been several studies on human behavior using errant pieces of mail. Letters with postage were tossed into a mailbox at a rate of almost 80%. If the letter contained money, still more than 50% were forwarded.[35] In an experiment in which a wallet was placed in the letter, passersby in New York forwarded untouched wallets at a rate of almost 50%.[36] Gneezy's sender-receiver game experiment using students showed[37] that many people tend towards the truth, even if they do worse because of it. Asymmetrical information is thus not always used to one's advantage.

The results of these experiments can be explained by altruism, honesty as a human character trait or by corresponding social norms. That the addressees of the letter were unknown, and thus the finder could not identify with them, speaks for the explanation that moral behavior derives from norms.[38] On the other hand, there are no sanctions in this example that would create the norms, since the behavior was believed to be unobserved.

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[35] See Lück, Helmut E./Manz, Wolfgang (1973).

[36] See Hornstein, Harvey A./Fisch, Elisha/Holmes, Michael (1968).

[37] See Gneezy, Uri (2005), pp. 387.

[38] See Hausmann, Daniel M./McPherson, Michael (2006), p. 86.

3.4 Fairness As Motivation

Alan Sanfeys conducted the "ultimatum game" in the laboratory at Princeton University. Two subjects are told to divide $10 amongst themselves. The first (proposer) get the whole amount and can decide how much he gives the other. The second (responder) can then decide whether he accepts or rejects the portion he is offered. If he rejects the offer, neither gets anything.

Game 2 Ultimatum Game
Two students are to split 10 pieces of chewing gum. The first one receives everything and can determine how much he gives to the second. The second can then decide whether to accept or reject the gift. If he does not accept the money, they both get nothing.

The ultimatum game is normally played with 10$ instead of chewing gum. Rational behavior would dictate that the second subject agree to any amount offered. Regardless of how much he is given, he would still be better off than if he were to reject it and both get nothing.[39] People apparently behave quite differently, however. If the offer is seen as too low, many subjects rejected the offer completely and preferred to have nothing.[40] Brain activity values (MRT) showed that the lower the offer was, the more the prefrontal cortex (PFC), responsible for rational thinking, was overshadowed by the Insula, responsible for emotions. The interpretation of this experiment indicates that the positive decision to gain money was increasingly superimposed by the negative feeling of being treated badly by the other subject.[41]

This interesting neurological experiment from 2003 was lauded by the press for the realization that homo economicus is a fiction, yet the experiment can be interpreted differently if we take into account that humans are social animals, as Aristotle suggested.[42] We can interpret the second subject's rejection of an offer felt to be too low as an expression of the sense of fairness. It seems obvious that $10 should be split evenly among equals with $5 each. If we assume that humans are social animals descended from apes, we can call the behavior of rejecting a low offer irrational, yet goal-oriented and effective. How would such a group experiment play out in real life? By rejecting the offer, the second subject signals that he rejects the

[39] It was interesting to see that in the ultimatum games students who had the course microeconomic before and therefore knew the experiment for showing not rational behavior gave only one of the ten chewing gums to the second person. Their argument was that they wanted to behave rational and the other person should be grateful to receive anything.

[40] The ultimatum game was adapted and executed under competitive conditions with a proposer and several responders. Only the first responder to accept the proposer's offer received a payout. The responders accepted even very low offers in this situation. See Holzmann, Robert (2015), p. 130 and Roth, A. E./Prasnikar, V./Okuno-Fujiwara, M./Zamir, p. (1991). Such a something or nothing situation is not comparable to the competition based on performance as per the do-ut-des principle of the markets.

[41] See Sanfey, Alan et al. (2002). The ultimatum game has existed since the 1980s. See Güth, W./Schmittberger R./Schwarze, B. (1982).

[42] See Aristoteles (1944), 1253a.

social behavior of the first subject as unfair. He is also showing the proposer that his behavior can have negative consequences for him in the group if the other members agree that he has violated a norm, namely how sustenance is divided within a group. This behavior is programmed into us as humans and could not be denied in another experiment with different parameters. The refusal to accept the amount could alternatively mean that the second subject wishes to signal the first that he is not willing to be disparaged in the group with a lesser share of sustenance, and that the first subject has maneuvered himself into a conflict situation with his offer and the second subject will get him back at the next opportunity regardless of the experiment.[43] A variant of the ultimatum game is the dictator game.

Game 3: Dictator Game
Two students are to split 10 pieces of chewing gum. The first one receives everything and can determine how much he gives to the second. The second has to accept the offer.

In this game the second subject has no influence on the final distribution, rather he must accept what the first subject gives him. Here it would rationally maximize one's utility for the first subject to keep everything. The dictator game is normally played with 10$ instead of chewing gum. The experiment shows however, that on average about 30% is given to the second subject, again showing an altruistic sense of justice.[44]

Research on primates has also concluded that fairness is a central principle for creating cooperation in a group. Frans de Waal and Sarah Brosnan at Emory University in Atlanta conducted experiments with capuchin monkeys, in which different rewards – a grape or a cucumber – were given for the same effort. The monkeys refused the cucumber as a lesser reward for the same effort, leading De Waal and Brosnan to conclude that primates have an innate sense of fairness that has evolved to develop cooperation. Susan Perry from the Max Planck Institute for Evolutionary Anthropology in Leipzig also did experiments with capuchin monkeys and arrived at similar conclusions.[45]

The experiment also shows the influence of group behavior on economic decisions, which has been heretofore neglected in economic science. Fairness as an ethical value has concerned people as long as they have existed. Fairness, or justice, is the objective of the basic normative principle of human co-habitation (principle of social behavior).[46] This is the prerequisite for an individual to participate in the division of labor of a group. The individual will only adapt to group's demands and work cooperatively if his share from the labor distribution is felt to be fair. Without fairness there is no added value from labor distribution for our society and civilization (emergence). That means for a company as the group with which he earns his

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[43] See Conrad, Christian A. (2010), pp. 125 and Fehr, Ernst/Fischbacher, Urs (2003), pp. 785.

[44] See Holzmann, Robert (2015), p. 129.

[45] See Brosnan, Sarah F./de Waal, Frans B. M. (2003); Perry, Susan (2003) and Brosnan, Sarah F./de Waal, Frans B. M. (2014).

[46] See Höffe, Otfried (1992), pp. 91.

livings the employee will adapt to supervisors demands and work cooperatively if his share from the labor distribution is felt to be fair. If not he will stop cooperation, which is important information for leadership theory. To be successful the leader has to explain this distribution share to each individual in order to create motivation to work in a group.

Subjectively, fairness is understood as an ethical value. The classical world considered it a fundamental virtue as well as a guiding principle for action, which prevented any overreaching one's fellow humans. Even though there are no sanctioned norms, a righteous person behaves ethically by not taking advantage of others even when he has the opportunity; he in fact gives others their share.

3.5 Human Intelligence

What abilities are decisive in life? What makes it possible for people to cope with the challenges from their environment? What makes people successful? These are questions about human intelligence. Today intelligence is mainly defined as the correctness and speed with which unknown tasks are solved.[47] There used to be three forms of intelligence identified. The ones necessary here are the mathematical, spatial and linguistic intelligence, whereby the mathematical is the most well-known. Mathematics is understood here to be the pure form of abstract and logical thought. People gifted with this intelligence are able to use chains of proof and rules that can be recorded with figures. Mathematics is considered nature's blueprint because many laws of nature can be represented mathematically. The most famous of those with this feature of intelligence was Albert Einstein, the founder of the Theory of Relativity. The second, spatial intelligence, allows three-dimensional comprehension and processing of the environment as forms, spaces or objects. The embodiment of this form of intelligence is considered to be Michelangelo Buonarotti with his statue of David and the images in the Sistine Chapel with perfect perspective. The third traditional form of intelligence is a gift with languages. This allows hearing through words, written and verbal expression and independent reflection through writing. An example here would be Johann Wolfgang von Goethe with a vocabulary of around 90,000 words. The average person has between 2000 and 5000 words. These three traditional forms of intelligence have determined the way human capabilities are perceived and perhaps their valuation for decades. The explanatory power of these gifs for success in solving tasks in life is quite limited, however. According to the Harvard Professor for Psychology Howard Gardner, in the best case these three traditional forms of intelligence could only predict scholastic success to a certain extent. According to Gardner there are some careers whose demands are concentrated in these forms of intelligence, such as lawyers through formulations and verbal arguments, physicists who work with mathematical formulas or pilots who must think spatially. For most other careers however, such as managers,

[47] See http://wirtschaftneudenken.blogspot.de/2010/09/abschied-vom-iq.html

politicians, musicians etc., these criteria are not suited to determining potential. This fact caused the Gardner to investigate other forms of intelligence. In the 1980s he developed his radical concept of multiple types of intelligence, in which he included four additional gifts. In the meanwhile research has identified a total of ten forms of intelligence.

First there are the special forms of intelligence, such as the naturalist, musical and kinesthetic intelligence. Naturalist intelligence refers to a particular comprehension of nature and its products. Foresters, biologists, veterinarians and top chefs would be careers for this group. Alexander von Humbolt, who discovered and explained many interconnections with his field research would a prime example of naturalist intelligence. The first example to come to mind for musical intelligence is the genius Wolfgang Amadeus Mozart. Kinesthetic intelligence is relatively unknown. Science considers it to be the ability to use one's body to complete tasks. A famous kinesthetic genius would be the silent film actor Charlie Chaplin.

The four most important forms of intelligence to have been recently identified are the existential, interpersonal, intrapersonal and emotional intelligence. Relationships between people, social competence or soft-facts had been completely neglected by the traditional forms of intelligence. Interpersonal intelligence allows one to recognize and understand the motives and desires of other people. In particular teachers, politicians and sales people need this kind of empathic ability. Only someone who can put him or herself in the shoes of others can motivate and recognize both strengths and weaknesses to then best apply, encourage and demand them, developing them optimally, as an ideal manager does. Another example is politicians who must recognize the desires of their voters in order to be successful.

The transitions between the abilities are fluid however, and there are many overlaps depending on the type of demands made. Thus rhetorical abilities belong to linguistic abilities as well as to interpersonal intelligence, since a good speaker must gauge what the listeners are receiving and react rhetorically to their reactions. Overlaps are particularly numerous for interpersonal relationships. This is how the American Daniel Goleman developed the concept of emotional intelligence in the mid-90s. He considers this to be not only recognizing and dealing with the feelings of others, but applies this to one's own feelings as well. Emotional intelligence is thus located between the interpersonal and intrapersonal intelligence as the capacity to deal with human emotions. Mahatma Gandhi represents an excellent example of emotional intelligence. He was able to judge the feeling of his compatriots, influence them and channel them into passive resistance as well as to control his own feelings in an exemplary manner, making him an excellent leader. He was a model for his compatriots in suffering. The nickname Gandhi translates as "large spirit." The intrapersonal capacity to understand one's self makes it possible to differentiate between realistic goals and personal dreams, an ability not to underestimated, as it is then possible to achieve an inner balance at live with inner harmony. In 1896 Sigmund Freud described scientifically for the first time how self-knowledge is the basis for human existence on earth, and inner peace. Internal balance and finding the right relationship between reality and a person's capacities and desires is the basis for internal force and perseverance, and thus for a person's long-term success.

The last three forms of intelligence for social competence are not only determining factors for managers, but also for the successful integration in a team. Only he who knows himself and understands others can offer his strengths and weaknesses to the team in a way that increases the team's ability to perform. The last of the new forms of intelligence is the existential intelligence. It is attributed mostly to philosophers, priests and authors, because they are capable of addressing the fundamental questions about the world and humanity. Immanuel Kant is our example here, who significantly contributed to modern thinking with his work "Critique of pure reason" (1781) and his categorical imperative,[48] as well as his thoughts on enlightenment. This intelligence can generally be characterized as the capacity to get to the source the past and future of things, or to put social or environmental observations into a larger perspective. This form of intelligence is therefore important when addressing that big picture of human structures. This also applies for economic science as the science of people in economic interconnections.[49]

For the question of the extent to which man behaves ethically, compassion, that is, sympathy with other people, plays an outstanding role. This is an emotion. In principle, it is therefore necessary to distinguish between a rational impact assessment and emotion-driven compassion. This also occurs in two separate brain areas, as the case of the railway worker Phineas Gage showed. In an accident, an iron rod, 1 m long and 3 cm wide, had been shot through his head. He survived this and, surprisingly, the basic cognitive basic functions were unaffected as perception (except for the loss of an eye), intelligence, memory and speech. Only his social intelligence seemed to be impaired. Before, he was a popular, prudent and successful personality, after the accident he had problems, long-term decisions and social contacts. It turned out in a later investigation that especially brain regions had been damaged, which are added to the processing of emotions.[50] As in experiments where the brain activity was measured by means of functional magnetic resonance tomographs (fMRI), emotional inhibitions occurred in subjects especially when: (1). a personal responsibility (ME) was (2). for direct physical damage (HURT) (3). A physically present or alive person (YOU) was present (MeHurtYou).[51]

Haidt et al. succeeded in demonstrating the influence of emotions caused by norms, in particular, on moral decisions by placing people before decision – making alternatives which did not result in objective harm but were morally problematic, such as the eating of the deceased dog before the Background that dog meat should taste good or use a bust American flag to wipe the toilet.[52]

Where do we place the character of morality with the background described above? Morality, like all characteristics, is partially inherent and can be helpful in

[48] People need to select maxims to guide their actions, which can simultaneously function as general laws.

[49] See Gardner, Howard (1983); Gardner, Howard/Kornhaber, Mindy L. (1996); Gardner, Howard (1999) and Schlesinger, Christian (2007).

[50] See Holzmann, Robert (2015), p. 117.

[51] See Greene, Joshua D./Nystrom, Leigh E./Engell, Andrew D./Darley, John M. (2004).

[52] See Haidt, J./Koller, S./Dias, M. (1993).

solving unknown tasks in life, just like the forms of intelligence. It belongs to the social abilities, or more exactly to interpersonal intelligence. As we have already shown, morality is the basis for trust and thus also for productive human social existence. Repeated moral behavior inspires others to do the same, to compromise in transactions, to invest for example, and to trust in the later reciprocal action of a business partner, which leads moral people to experience more interpersonal success than immoral people. There is a negative form of interpersonal intelligence, which we call cleverness. We understand cleverness to be the ability to enrich one's self immorally at the cost of others, to gain advantages, without being discovered. This ability is unfortunately often a key to success in life. From the perspective of the society, this success should be prevented because it damages individuals and the system as a whole.

The conclusions on can draw from these new findings are quite reassuring. When someone has not scored well in the traditional three forms of intelligence, it neither means that they will be unsuccessful, nor that they are dumb. Intelligence as the capacity to be successful in life is as complex and diverse as the challenges of life itself. Analysis and problem simplification can be trained with a study in an orchestra score. In order to be successful in a group, one needs both interpersonal and emotional intelligence. There are many overlapping abilities, so that it seems almost impossible to definitively classify a person's intelligence or to evaluate someone in relation to their chances in life. Everyone has strengths and weaknesses that are often balanced, even at extremes. All too often we find engineers who cannot use their ingenious inventions because they lack the ability to sell it. Intelligence can also be learned to a certain degree. The fundamental abilities are inherited, but they can be increased by around 15% through training.

From the various forms of intelligence one can conclude that people are able to understand the effect of their behavior on the welfare of third parties and to feel compassion. Furthermore, they show that human nature goes far beyond the homo oeconomicus.

On the whole, it may be doubted that all the intelligentsia worked out by Gardner can be proved empirically. Up to now, social intelligence has been isolated and empirical proof has been given of a connection with the success of personal influence on people. In addition, links between the academic degree as well as age and social intelligence were identified.[53]

[53] See Eshghi, Parto/Arofzad, Shahram /Hosaini, Taghi Agha (2013). Zur Diskussion See Gardner, Howard /Moran, Seana (2006).

3.6 The Cultural Impact

Empirical studies confirm a familiar basic principle of raising children, or human socialization in general. Social, or more exactly, moral and ethical behavior can be taught and learned.[54] The reverse conclusion is that moral behavior weakens whenever it is no longer taught or demonstrated. For this reason there is a duty to educate children and socialize members of a society in all areas. If this does not take place, or only poorly, the effects will be felt in all areas, in companies and in national economies. The effects are gradual, noticeable only over the longer term, similar to the effects of pollution in the environment. It often pays off for individuals to violate social rules as long as others keep to them. There is also the fact that socialization as a practiced social behavior and moral values can be lost. Like a young cat dependent on the role model of its mother to catch mice despite its hunting instinct, humans need role models, guidelines and education, including punitive measures for moral transgressions. This allows them to become functional members of the human community in a positive sense. If values are not passed on and socialization does not occur, this human capital, the experiences of living together, is lost and cannot be given to the next generation.

Morality and customs of managers are also products of each respective society. Morality of the individual is partially inherent and partially trained through the social and familial socialization process.[55] According to David Hume, Stinchcombe and Friedrich A. von Hayek there is also a cultural development process. Sociology calls this the process of natural selection. The unsuitable behavioral patterns and rules (institutions) die out with the groups that have selected them. Cultural development is a process of trial and error, with uncertain results. Legal constructs (institutional rules) such as private property, money and credit, even the market economy itself, are discoveries that brought benefits to groups that initiated them. Forms of social life and societal organization are tried out and taken on if they provide economic success and social acceptance, and rejected if they do not. If a society does not behave in this manner, it risks going under in the competition with other societies with its poorer organization, which is the explanation for such a developmental process.[56] One could argue, for example, that when the Socialist and Communist systems collapsed, private property had instituted itself. The process of natural selection takes place through a very slow process of selection. The decisive factor is selection through human thought and learning from experience (trial and error). This applies especially for the creation of economic order and in general of social order.

[54] One study was conducted in Germany with craftsmen and one in the USA with students (lecture “business ethics”). See Steinmann, H./Löhr, A. (1994), pp. 174, 190 and Noll, Bernd (2002), p. 144.

[55] See Wiswede, Günther (1985), p. 195.

[56] See Wiswede, Günther (1985), p. 195, Hayek, Friedrich August von (1976), p. 39, 40 und 59; Hayek, Friedrich August von (1979), pp. 154 and 167 and Noll, Bernd (2002), p. 29.

The social evaluation of good and evil is also subjected to this principle of cultural selection. A society defines what is good and bad for itself, just as does every individual. Society develops norms for its protection and welfare. If it develops the wrong norms it can cause its destruction. This awareness is very broad and is not applicable only to moral norms, but to all behavioral guidelines.

People orient themselves by other people. If traditional values are rejected, in youth for example, or by influential social classes, first a trend is created as a new mainstream culture. We may refer to this as the zeitgeist, which represents the temporary nature of this trend. A regeneration is then already almost impossible, if the old values no longer reflect common sense in the society. If the moral values are no longer common sense, or dominant, there are no longer sanctions from the society for moral missteps. At some point the values are forgotten. The respective social culture is then lost forever, it dies out, like so many cultures of the native peoples in earlier colonies during the European socialization. We are not talking about the natural questioning of parental values during one's youth and the process of constant rejuvenation that results for social orientation and values, but of massive cultural ruptures. A rupture of this kind can be brought about by exceptional events, such as a war. Families are torn apart in war, which impedes the natural process of passing on values. Social values are particularly called into question when a war is lost and the dominant social and power structures collapse. Not only is an authority vacuum created, but there seems to be a tendency to take on the social norms and values of the superior, victorious society.

3.7 Conclusion and Summary

What motivation for ethical behavior do we have? There are many people who selflessly do good deeds and feel better for doing so, not worse. This gives us a selfless motivation that contradicts the theory of utility maximization, or the concept of homo economicus. The fact that selfless, or even self-sacrificing, acts exists shows that such an ethic is not unrealistic. Volunteer work and individuals like Mother Theresa are clear examples. This behavior can be explained by a more general theory of maximizing happiness, which is behind theories like the Happiness Theory from Bentham and Mill. Many people are generally good, which is to say they have an ethical disposition.

Selfless acts generally garner prestige in a society, presenting another motivation for ethical behavior. Both motivations are bases for behavior relevant to the satisfaction of a person's basic needs, according to Maslow's[57] hierarchy of needs. Beyond maximizing one's advantage, people need to feel a purpose in life. There are people who measure their benefit or value as a person by how beneficial they are to others. Behavioral theories have given too little consideration to intrinsic motivations until now. Here we are looking at an enlightened human ethos. People consciously behave

[57] See Maslow, A. H. (1943).

ethically because they understand the importance of such behavior to society, or because they empathize with other people. Normally these motivations only become meaningful after all of one's basic needs have been met, and they cannot be presupposed for every person. Nonetheless, such ethical motivations must not be disregarded. Our representative democracy in fact demands altruistic behavior from people as a prerequisite to allowing delegates to represent the voter's interests. This expanded theory allows us to explain altruism, helping others and sympathy.

The genetic predisposition to cooperative behavior we have described is not sufficient on its own, however. Hobbes recognized that cooperative behavior must be worthwhile for the individual, who must also be able to count on it from others, since we would otherwise have anarchy. Luhmann considers trust to be a tool used to reduce the complexity of social interactions.[58] Trust can only be ensured by a society rewarding cooperative behavior and punishing non-cooperative behavior. Without controls and sanctions there is no guarantee of fair, thus economically ethical, behavior.

Therefore moral hazards are extremely dangerous. The existing asymmetries of bonus compensation schemes have led to a divergence of interests between employees on the one hand and the health of financial institutions and other companies at large on the other hand. Remuneration and bonuses depend on short-term profitability, which increases share prices in the short-term, but not the long-term health of the company. In the financial system, investment managers increased the risks for their employer by buying highly profitable but risky assets and were rewarded with high bonuses, which led to the financial crisis in the long term. Without accountability variable compensation schemes become unilateral bonus maximation schemes with negative effects for the company and the principal. It means risking other people's money which will generally be abused unethically.[59]

Moreover people are influenced in their behavior by their view of the world. Ideas and attitudes, or moral values, must be shown by example and included in education. This makes schools of economic science particularly important. There are those who blame management training for catastrophes such as Enron, the subprime crisis etc. Thomas Lindsay, once Dean of the University of Dallas, points to studies before Enron that prove managers rarely fail economically or morally because of a lack of professional knowledge. What they are generally missing is what Aristotle calls "wisdom," to be understood as interpersonal capabilities and practical knowledge. In Lindsay's opinion the education for managers was excessively subject-oriented, and the moral capabilities of the students are almost completely lost through unadulterated profit maximization. Aristotle said that true leadership is based on the ability to recognize and serve the good of the community. To train these abilities one needs much more than a professional education, one needs instruction in history, philosophy, literature, theology and logic.[60]

[58] See Luhmann, Niklas (2000).

[59] See Conrad, Christian A. (2015).

[60] See Bennis, Warren G./O'Toole, James (2005), p. 95.

If households maximize their benefits and companies maximize their profits, it is economically efficient and economic science would consider this a goal for orientation. Good businessmen always act to maximize profit. Whoever wants to be a good businessman should act accordingly. Good households also act to maximize benefits. Thus private persons should also act to maximize benefits. This is the world being taught to young students of economic science in the Western industrial countries. Many would say that this is how the world is, and people ruthlessly maximize their benefits. What about the idea that people are neither wholly good nor wholly bad – as this paper has shown – but they were only told to behave badly? The world would be worse than it had to be.

In the company, management must consider the employees' strong sense of justice. The distribution of income in the company must be explained to the employees so that it is accepted and the employee remains motivated. In addition, a key task of management is to ensure that the company is also justified among the employees.

The economics, with their focus on a pure objective utility maximization, are far from human reality. Although an exclusively objective benefit allows for measurability and thus the use of deterministic decision-making models, they lead to the wrong results. There are three systematic errors:

1. Economic sciences are exclusively psychologically oriented. People decide in a social environment, which is why sociology is at least as important for behavior as psychology. Motives such as social rewards or sanctions are not taken into account. For instance is acceptance by others is a very important behavioral incentive.
2. Taking the objective as the basis for human decision-making, the influence of the group (the company) or society must also be taken into account. Norms that are sanctioned reduce payouts and are critical to decision-making.
3. Finally, the objective benefit is not decisive but the subjectively perceived. However, this is difficult to measure from the outside. However, decision models that build on only objective material utility are misrepresentative and cannot explain many human motives, such as emotions, envy, sense of justice, and compassion. Man is stunted with the homo oeconomicus. It would therefore be more realistic to base the explanation of human behavior on the maximization of happiness as on benefit maximization.

Comprehension Questions

1. Describe the characteristics of homo oeconomicus. Is that image of human beings realistic?
2. What role do the "strong reciprocators" fulfill? What importance do societal norms have for society?
3. Why have many ethical misdeeds taken place especially within the finance sector?
4. What importance does the justice of salary distribution for a company have?

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Chapter 4
Ethical Problems of the Economy: Enron, Subprime & Co. – From Crisis to Crisis

What Follows Why?
The following chapter should give you an impession of current ethical problems in the economy.

Learning Goals
You should be able to describe the ethical problems in your own words.

4.1 Enron, Worldcom and Co.

Fraud used to be a rare problem for some individual companies. The series of business scandals started at the beginning of the twenty-first century. The global economy was shaken by a series of company crises in the USA. In order to improve their share prices, many companies in the USA had manipulated their records and touched up their numbers. In 2000 alone, 233 companies had to correct their accounts after coming under pressure from the SEC (Securities Exchange Commission), which incurred a corresponding drop in the share prices. For example, the second largest American telecommunications company, Worldcom, had manipulated its accounts by $7.15 billion, and the well-known copier manufacturer Xerox had falsely claimed billions in profits for 1998 and 1999, as well as pre-tax profits for 2000 that were $845 million too high. The most flagrant case was the model company Enron. The seventh largest US company was the darling of the stock analysts and the economic press for years. The press named Enron as the most innovative and admired American company and selected its board as one of the five best in 2000. Enron had increasing profits every quarter for 5 years in a row. Its profits were originally derived from gas pipelines, but it then developed into an innovative trade company. Enron dealt in everything in and around energy, especially with derivatives such as futures on weather development. From the CEO Jeff Skilling (as of 2001), who had a Harvard degree and came from the famous consulting firm Mc Kinsey, to the

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renown auditing firm Arthur Andersen, Enron had the reputation of representing the best that America's economic elite had to offer. Coming straight from Mc Kinsey, Skilling[1] in particular determined the strategic direction and the company culture at Enron. He wanted to get the very most he possibly could out of his employees. He demanded the highest level of commitment and quality in order to live up to the company slogan "The world's leading company." He implemented special incentive mechanisms, and traders were paid according to their success based on their contract volume. That wasn't enough, however. True to the Mc Kinsey motto of "Up or out," he organized employee rankings in which the bottom 20% would most likely be dismissed. In accordance with the "survival of the fittest" principle, he was always assured that his employees were performing to the top of their abilities. This incentive system was coupled with a strict hierarchical subordination; "If you didn't act like a light bulb came on pretty quick, Skilling would dismiss you" (a portfolio manager quoted in Fortune).[2] The CEO of Lehman is said to have had a similar style of leadership. His employees were to afraid to report their losses. And employees like Mike Gelband, Manager of the real estate department was made redundant because he warned about the rising risks of Lehmans real estate investments.[3]

How did the employees react? They did everything they could to make Skilling happy. The volumes of trade contracts were inflated. Supervisors were not notified of mistakes. No mistakes were allowed… at Enron. Apparently employees worked constantly and perfectly. As a whole there was an atmosphere of fear and mistrust and mutual cheating. The traders were afraid to use the restroom, because they feared that their colleagues could get information from their computer about positions that had come in, in order to bet on the market and thus devalue their positions. In the end the employees neither made Skilling happy, nor did they give him the productivity he wanted. He didn't reach them. His system of hardness and fear created the opposite of what he wanted. The productive forces of the employees were not directed in such a way that they achieved the company goals, which is why Enron was not able to be the "World's leading company."

In the end everything was exposed. Enron had claimed around $1 billion in nonexistent profits and the renowned auditor Arthur Andersen certified the manipulated balances, which not only spelled the end for both firms, but also shook the entire finance branch. How could something like that happen? How could the famous rating agencies, banks, investment banks and stock analysts all be mistaken? More precisely, why did no one notice anything? We will address this question later. First we must be aware that the balance sheets were faked, which made it very difficult for the finance market institutes to discover what Enron was up to.

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[1] Skillings was and is considered very intelligent, but arrogant as well. Just like Lay, he was charged with fraud, money laundering and conspiracy. The accusations proved difficult to prove however, since Skillings had given all instructions verbally. See Handelsblatt dated January 27/28/29 2006, p. 15.

[2] Mclean, Bethany (2001).

[3] See Der Spiegel 11/2009, pp. 43.

The honor of having uncovered the deceptions belongs to two short-sellers named Jim Chanos and Doug Millet,[4] who worked for the as yet relatively unknown company Kynikos Associates. They did not have any more information that other market participants, but they were apparently more attentive, because a lucrative short-selling business was in the air at Enron, thus the sale of borrowed Enron stocks, which creates profit from the return of stocks bought at a lower price. They pointed out that Enron's operating margin of 5% in 2000 had fallen to below 2% at the beginning of 2001, and that they still couldn't figure out how Enron really earned all its money. The cash flow seemed to have no relation to the profits recorded, being much too low. It also seemed amazing that Skilling was selling his stock at a price of $80, while he maintained publicly that they were actually worth $126. Skilling's predecessor as CEO, Kenneth Lay, also sold $70 million worth of Enron stocks in 2001, while he was busy recommending Enron employees to buy Enron stocks as a secure investment. Enron was unable to refute the accusations in public. When the stock value landed at $40, Skilling left the company and Lay became CEO again. Lay also refuted the rumors about Enron's problems, saying there were neither "accounting" nor "trading issues," nor "reserve issues." Finally Enron registered a loss of $618 million on October 16, 2001, and wrote off $1.6 billion of assets. Lay still insisted on October 23 that Enron's business was doing well. The downgrade of the invest grade from S&P caused them to declare bankruptcy, due to the repayment requirement for outsourced debts of $4 billion in the related party company.

Chanos had pointed to the related party issue as well. Enron had not consolidated its debts in the balance sheets, rather it shoveled them onto the company managed by Enron employees and booked paper profit. Only a few people knew there was a fallback clause for the credit in case Enron's rating should fall under the investment grade. The bankruptcy assets destroyed were valued at around $65 billion (maximum market value), which is somewhere around the gross domestic product of Libya or Syria, just to have an idea. In addition, there were damages from the failure of Enron as the contracting party for derivatives, which had also functioned as a security mechanism against risks for other companies.[5] From 1989 to 2001 Lay had sold Enron stocks for $300 million, mostly in stock options.[6]

In order to try and limit the loss of trust, the Business Round Table, a coalition of the CEOs from the 500 largest American stock companies wrote the following in February, 2002:

> "The United States has the best corporate governance, financial reporting, and securities market systems in the world. These systems work because of the adoption of the best practices by public companies with a framework of laws and regulations. The collapse of

[4] This is another example to show that not all information is included in the market prices, otherwise long term there would be no short sellers, or speculators. The majority of market participants can be mistake, they are only human. The market can be outperformed through better information and analyses.

[5] See Mclean, Bethany (2001), p. 53–58; Collin, Denis (2006), Fox, Loren (2006) and Markham, Jerry W. (2006).

[6] "Enron," http://en.wikipedia.org/wiki/Kenneth_Lay dated October 8, 2006.

the Enron Corporation is a profound and troubling exception to the overall record of success."[7]

Unfortunately Enron was not an isolated case. The next large failure was Worldcom due to manipulated balance sheets. Many similar cases followed, and not just in the USA.

4.1.1 The Consequences of Enron, Worldcom & Co.

Enron heads Jeff Skilling and Keneth Lay, as well as the head of Worldcom Bernie Ebbers, received prison sentences of several years for balance sheet tampering. In light of the numerous fraud scandals, the US government tightened reporting obligations and prison sentences for fraud with the Sarbane-Oxley Law. Alone Citygroup and J P Morgan Chase paid out around $9 billion in damage compensation to the victims of the Enron and Worldcom fraud. They accepted the compensation to avoid a lawsuit in which the plaintiffs could have accused them of complicity in balance sheet tampering. In addition, two managers of the US investment firm Merill Lynch were sentenced to several years in jail for complicity in Enron's fraud. They had signed a contract with Enron that served to cover up Enron's financial situation.[8]

The auditor Arthur Anderson was accused of improper accounting for the companies Sunbeam Products, Waste Management, Asia Pulp and Paper, the Baptist Foundation of Arizona and Enron. In 2002 Arthur Andersen was convicted of obstructing justice and lost their auditing license. Andersen employees had destroyed many Enron records that would have served as evidence. Arthur Andersen was then liquidated and left behind more than 100 civil claims and lawsuits.[9]

All in all the opportunity to improve the economic system out of the Enron, Worldcom & Co. scandals was missed, however. Politicians tend to react, not to act, which is why reforms were discussed after pressure from the outraged public, yet very little was implemented. Corporate liability from the top managers was quickly dropped, for example, and the public moved on. Most managers liked to see the Sarban-Oxley Act repealed already.[10] The auditing problem of off balance liabilities was not solved. Thus the next scandal had to come with the subprime crisis.

The problem of negative incentives (moral hazards) due to short-term unilateral constructed compensation schemes was not addressed. More problems became clear. With the deregulated energy market Enron was able to make money by manipulating the underlying energy price. They created an energy shortage. High-level politicians received donations for election campaigns from Enron. Politicians

[7] See Schwarz, Gunter Christian/Holland, Björn (2002), p. 1662.

[8] See Handelsblatt dated July 11, 2005, p. 21.

[9] See "Arthur Andersen," http://en.wikipedia.org/wiki/Arthur_Andersen, dated October 8, 2006.

[10] According to 3nd. Annual Board of Directors Study, Korn/Ferry International dated February 23, 2006, http://news.onvista.de/alle.html?ID_NEWS=20584380

deregulated the energy market. And Enron employees were placed in high governmental positions. Such an indirect lobbying is still an issue in the U.S.[11]

4.2 The Subprime Crisis, the Biggest Financial Crisis After 1929

In 2003, Warren Buffet stated of the credit derivatives market that they were "financial weapons of mass destruction, carrying dangers that, while now latent are potentially lethal." Others also warned that credit based derivatives coupled with a lack of transparency were leading to a significant concentration of risk. Unfortunately, they were right.

Derivative products such as CDOs (Collateralized Debt Obligations) can be directly traced as being one of the major factors leading to the subprime crisis and the greatest financial crisis since the Wall Street crash of 1929. CDOs are structured financial products comprised of a variety of loans, bonds, mortgages and credit derivatives such as Credit Default Swaps or CDSs. For the most part, CDOs were put together using home mortgages and then resold as investment products by the major Wall Street investment banks. These CDOs were structured to meet the requirements of the major US rating agencies which based their risk calculations on complicated economic models and statistical analysis. Two apparently ingenious combinations of factors made it possible to create an innovative financial product with a combined calculated risk in the portfolio lesser than the sum of the individual risk associated with each element in the portfolio.

The basis for the evaluation of risk associated with these financial products as calculated by the rating agencies was based upon the historical default rate of US mortgages. As this data was not always available, it was necessary to draw upon estimates that fit within established portfolio theories and expectations and which would produce the desired reduction of risk between two comparative portfolios. Part of this process was to investigate the relationships and correlations between the individual elements of these portfolios to determine the probability that both or more elements could be eliminated from risk calculations. The complex statistical financial models used by the rating agencies were not always understood or even available to those in the market place as investors. This situation was not considered to be an issue at the time, as the capital markets had a great deal of trust and confidence in the ratings provided by the rating agencies. For decades, the ratings provided by the rating agencies concerning potential risk had been used to determine the terms for credit and loans to borrowers in the capital markets. As a consequence of the subprime crisis, the objectivity of these ratings agencies has now been called into question, most notably due to their previous relationships with the investment banks for which they provided the CDO ratings.

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[11] See Ledgerwood, Shaun/Taylor, Gary (2016).

The second situation by which a portfolio rating could be improved was through the use and subordination of various "risk tranches". In the event of a default or failure of one of the elements or "tranches" in the portfolio, the most subordinated tranche (junior note) would be affected. This process would continue on up the scale to the tranches with AA to BB ratings, (mezzanine notes) and in the extreme case on up to the most senior tranches with AAA ratings.

For decades, the value of American real estate has steadily increased. After all, the USA has been a country of considerable growth both in terms of population and economic expansion. This growth has also been the basis for a historically low level of home mortgage defaults. For the most part, home values have been sufficient to cover outstanding mortgage balances in the event of a default. As a consequence, lenders were encouraged to offer ever-increasing mortgage loans based on the projected future value of homes in an ever-expanding market. As home values rose, lenders would offer homeowners access to their equity through refinancing or home equity lines of credit which would support even further consumption. Much of the mortgage financing made available to borrowers by Freddie Mac and Fannie Mae was also supported by political incentives to encourage home ownership among socially and economically disadvantaged minority groups. This initiative originated in the mid-1990s with the Clinton administration as lending criteria were relaxed[12] and continued under the Bush administration. In 2003, Congressman Ron Paul warned that this relaxed lending policy would eventually lead to individuals borrowing to buy homes that they could ill-afford and eventually require financial intervention on the part of government. In 1994, the market for subprime mortgages made up only 5% of the total mortgage market and amounted to $35 billion dollars, and by 2006 it had increased to become 20% of the mortgage market for a total of approximately $600 billion dollars. This increase in lending volume was only made possible by ever more relaxed lending standards. Borrowers were able to obtain mortgage loans without showing any proof of income or employment or assets, the so-called "ninja loans" meaning "No Income, No Job, and No Assets". This situation was further encouraged by ever-falling interest rates as initiated by the Federal Reserve under the leadership of Alan Greenspan, with short-term rates reaching a low of 1% in 2004. Subprime borrowers were also offered ARMs, or Adjustable Rate Mortgages with low, interest-only payments required, as well as "teaser loans" with initial interest rates well below market rates that would dramatically increase

[12] "… the Fannie Mae Corporation is easing the credit requirements on loans … The action … will encourage those banks to extend home mortgages to individuals whose credit is generally not good enough… Fannie Mae… has been under increasing pressure from the Clinton Administration to expand mortgage loans among low and moderate income people and felt pressure from stock holders to maintain its phenomenal growth in profits. In addition, banks, thrift institutions and mortgage companies have been pressing Fannie Mae to help them make more loans to so-called subprime borrowers whose incomes, credit ratings and savings are not good enough for conventional loans… Fannie Mae is taking on significantly more risk… the government subsidized corporation may run into trouble… prompting a government rescue… the move is intended in part to increase the number of… home owners who tend to have worse credit ratings…" September 30, 1999 New York Times.

or reset at a later date. Also available were payment option loans which made it possible for borrowers to set their own repayment schedule and thereby postpone repayment for as long as possible. Altogether, US mortgage borrowing rose from $680 billion in 1974 to $14 trillion in 2001. From a total of 8.8 million homeowners with mortgages, about 10.8% had no actual equity in their property or, in fact, owed more than their home was worth.

Average home values in the USA increased 126% from 1997 to 2006, while the relationship between home values and annual income changed from a ratio of 2.9 in 2001 to 4.6 in 2006. This dramatic change in home values, as compared with annual income, was not considered a problem as long as borrowers were able to service their debt and maintain their mortgage payments. The crisis only came about as a consequence of changing interest rates and the payment structures built into these loans.

Banks can, but in a limited manner, restructure loan intervals as needed to meet business requirements but if they require refinancing at a later date, then it will be necessary for them to draw upon their own liquidity. Therefore every banking student is taught the golden rule of lending, which is to restructure loans through refinancing at appropriate coverage intervals.

When restructuring loans, the risks associated with changing interest rates and refinancing are to be carried and collateralized by the banks themselves. These fundamental rules of finance were unfortunately ignored when it came to the issuance of CDOs by investment banks, which finally amounted to a market value of over $2 trillion dollars. Long-term mortgages were repackaged and sold by the investment banks as special purpose vehicles (conduits) and collateralized at fairly low capital ratios through the use of short-term commercial paper (CPs). In this way, the CDOs could be refinanced at lower interest rates which created more profitable margins for the banks. The CDOs in these "special purpose entities" did not surface on the bank's balance sheet. As was the case with Enron, these obligations were not listed as consolidated third party liabilities and therefore not readily apparent at first glance. On bank balance sheets these obligations were simply listed as possible liabilities in the comments section and often escaped notice. In the unlikely event that banks were unable to sell these securities on the market, they would be required to provide adequate liquidity to cover these obligations. High leveraging of stock purchases was also a reason for the financial crisis in 1929.

Deregulation further encouraged the direct and indirect use of leverage by investment banks. For example, in 2004 the SEC allowed investment banks to expand their use of leverage by lowering their capital margin requirement from 8% to 6%. By 2007, the five largest US investment banks had increased their borrowing for investment purposes to $4.1 trillion dollars, which equalled approximately 30% of the US gross domestic product. What motivated the investment banks to take on this level of risk? This was the era of the "shareholder value concept", of short-term gain and exceptional bonuses. The simplest way to increase shareholder value and therefore also stock value was to use leverage to boost returns on investment. Finally, in order for a bank to receive a rating of "excellent" from the rating agencies, they were required to show a 25% return on investment of capital and therefore a favourable rating for future refinancing. An attractive aspect of CDOs was that it was not required that they be rated as loans, but could be rated as a security product. This classification allowed the investment banks to realize additional profits by selling them on to other investors and not hold bank funds in reserve as collateral.

Using CDOs, investment banks were therefore able to boost their profitability on invested capital as well as their internal rate of return. Loans would be classified as CDO securities and therefore positively influence the banks balance sheet. As securities, these CDOs would appear to be without risk. In addition, the rating agencies would assign them AAA status, indicating that these "securities" were without risk. As securities, the CDOs were not subject to the strict federal regulations required for debt products nor would they have to be evaluated as debt obligations on the books of the already highly leveraged banks. Free from complying with external financial requirements and internal lending limits, investment bankers were able to secure profitable sources of revenue and therefore substantial bonuses as well. By repackaging US mortgages as investment products, bankers were able to realize approximately $23.9 billion dollars in bonus payments in 2006. In 2007, Swiss bank UBS paid out $10 billion Swiss Francs in bonus payments alone. The availability and easy access to credit for home mortgages encouraged not only dealers but also lenders who provided loans to ever less qualified borrowers. In the end, these lenders were selling these loans on to other investors and therefore did not have to contend with the risk. The relationship between the lenders issuance of credit and mortgages and the associated risk of default were distinctly separated from one another, which lead to a fundamental violation of the market (order) principles of accountability and transparency. The exceptionally complex structure of the CDOs also contributed to this lack of transparency. It only became clear later that it was all but impossible to separate the various problem loans within the CDOs from the total in the portfolio, and impossible to trace them back to the original borrowers. Also, the system of bonus payments made to bankers selling the CDOs appears to be in contradiction to principles of accountability, as their bonuses were based on short-term profitability while the potential long-term negative consequences of their actions were ignored.

The bubble in the US housing market burst in 2006. A contributing factor was the dramatic rise in short-term interest rates which made it impossible for many mortgage borrowers to maintain their payments. This rise in interest rates lead to ever greater defaults and bank repossessions and home prices fell. The consequences for the financial sector first became apparent in February 2007 as HSBC was compelled to write off loans repackaged as CDOs valued $10.5 billion dollars. While serious, the crisis seemed to be limited to the banking sector and did not pose a threat to the real economy. In November 2007, the volume of subprime mortgages was valued at $148 billion dollars. At this point, the extreme difficulty in placing an accurate value on the CDOs became all too apparent. The lack of transparency associated with the CDOs and the high level of risk they carried due to the subprime mortgages they contained made them all but impossible to sell or accurately value. The market for CDOs collapsed entirely, leading to a crisis of capital liquidity for those banks carrying them on their books. This issue lead to an unexpected reduction of liquidity at the banks. In December, the amount of subprime debt was corrected from $200 billion to $300 billion, and then finally in March 2008 from $350 billion to $600 billion dollars.

A rating of AAA was now considered worthless and all trust in the rating agencies had been lost. Without accurate and reliable ratings from the agencies, the capital markets were crippled. It soon became obvious that the crisis was not limited to just the US. As CDOs had been sold on the international market, the risk that they carried was now also an international problem. Swiss banks such as UBS, and German banks IKB and Sachsen Landes Bank had built up considerable portfolios filled with CDOs and as a consequence experienced severe liquidity problems. In addition, these banks required ever increasing amounts of fresh capital to cover the write-offs associated with CDOs and to support lines of liquidity. The banks which had invested too much of their client's capital were in danger of going bankrupt. US investment banks and larger banks such as UBS were able to raise additional capital on their own, while banks such as Germany's IKB and Sachsen Landes Bank had to be rescued by the German federal government. British mortgage lender Northern Rock experienced a run on the bank and had to be nationalized.

The crisis continued to expand. Two basic issues became apparent: increasing suspicion and mistrust between banks and ever further write-offs due to CDOs, which served to accelerate the crisis of liquidity and available capital. Banks felt that they could no longer trust one another and therefore stopped lending to each other. Without transparency and trust between banks, no one could be sure which banks were solvent and how much remaining debt had to be written off. Ratings given to the banks by the ratings agencies could no longer be relied upon. The interbanking market collapsed. Banks without branch offices and therefore without access to investors found themselves short of liquidity. Central banks were compelled to provide infusions of capital into the marketplace and to lower interest rates. The quarterly reports by banks concerning their ever-increasing CDO related write-offs only served to further depress the already discouraged mood in the marketplace. As European banks primarily followed US-GAAP for accounting purposes as well as the internationally accepted IFRS standards, this lead to an even greater difficulty in accurately assigning a value to the CDOs. Following US accounting standards which tend to favour shareholder interests, securities and other financial products such as the CDOs must be "mark to market" to assign a current market value. In contrast to European accounting standards, the costs of acquisition are not included if a reduction in value is only temporary. Although home mortgages continued to operate for the most part unchanged, the market for CDOs had collapsed and banks were compelled to write down the market value of their CDOs by as much as 70%. This development culminated in the partial illiquidity of US investment bank Bear Stearns in March of 2008. The head of Germany's Deutsche Bank Josef Ackermann was quoted at this time as saying that "he no longer believed in the ability of the markets to self-correct and heal themselves".

Bankers called on the government to help them out of the situation. JP Morgan purchased Bear Stearns for $1.2 billion dollars after receiving a bail-out loan of $29 billion from the US Federal Reserve. After this action by the Federal Reserve the financial markets seemed to settle down. The danger of collapse of further large financial institutions seemed to be over. At the beginning of 2007, market participants started to believe that perhaps the worst of the subprime crisis was over, only to have the crisis flare up again. But the worst of the crisis was yet to come. The crisis would continue as the banks CDOs increasingly lost value and were written down to comply with accounting regulations. Prices for homes on the US real estate market and the almost non-existent CDO market continued to fall ever further. A shortage of liquidity compelled the banks to sell additional securities which lead to a vicious cycle of price declines. The mistrust of ratings assigned by the ratings agencies and the general uncertainty in the market lead to investors selling all forms of securities and to seek refuge in government bonds and treasuries.

In September 2008 the entire financial system came close to collapse. Only through a massive intervention by national governments up to and including the nationalization of many banks could the financial crisis be contained. Many newspapers compared the current financial crisis to that of the Wall Street crash of 1929. The US mortgage lender Silver State bank and many other smaller real estate lenders had to be closed and both major mortgage lenders Fannie Mae and Freddie Mac were nationalized. The growing crisis lead to the bankruptcy of Lehman Brothers, the 4th largest investment bank in the US. The CEO of a major German bank was quoted as saying "Lehman was the downfall that lead the financial crisis to a mass panic."

US Treasury secretary Paulson wanted to make an example of Lehman Brothers. Wall Street needed to realize that things could not continue as before, with the government prepared to bail out every bank facing insolvency,… as if in keeping with the motto "Privatization of profit and nationalization of loss." This concerned the concept of "moral hazard" as versus the adage "too big to fail". The majority of Americans were against the idea of using taxpayer money to bail out bankers on Wall Street. Paulson had drastically miscalculated the situation. Mohamed El-Erian, co-manager of the market's largest bond fund PIMCO made the case that, after the fall of Lehman Brothers all sense of trust and confidence was lost in the ability of financial institutions to be extricated from the crisis in an orderly fashion. In actuality, the collapse of Wall Street's 4th largest investment bank was an event beyond comprehension. All the major players in the financial markets had expected that the adage "too big to fail" certainly applied to Lehman Brothers, and that after the rescue of Bear Stearns by the federal government that Lehman Brothers could expect the same treatment.

That Paulson allowed the collapse of Lehman Brothers shook the financial world to its core. Nothing more seemed to be certain, and there was no longer any relying on a bail out. The danger for the financial system was that Lehman Brothers was one of the largest traders of derivatives and so its collapse would have profound consequences. The sword of Damocles, as wielded by George Soros in the form of billions of dollars of derivatives contracts, fell. After the bursting of the internet bubble banks discovered derivatives as the next major source of almost unlimited revenue potential. Derivatives are a form of obligation with their value tied to the occurrence of specific events in the financial markets. Options, for example, give the investor or speculator the right to buy or sell a specific security at specific price during a pre-determined period of time. Options, however, do not belong to the classic form of derivative. A derivative is normally used to cover an exposure to risk as a hedge. For example, the owner of a share of stock would use a sell option (Put-option) to sell his shares at a pre-determined price, or for speculation. The attraction of options derivatives is that with relatively little money an investor can speculate on the movement of a stock price with greater leverage, and also greater risk, than if he had to actually buy and own the underlying stock. Especially risky were a fairly new form of financial innovation known as Credit Default Swaps or CDSs. They also were developed in the US at the start of the 1990s as a form of hedge against loan risk. If a bank, for example, desires to reduce the risk of default for a loan that it has with a borrower, it can hedge the risk of default by buying a CDS from a third party. With a CDS it was possible for banks to increase their rates of return on capital while avoiding the use of their own capital to cover loans. In contrast, those providing the risk coverage were not bound by any specific regulations. They were not required to put up any capital of their own, so the actual risk of default was not covered. Investment banks and highly leveraged hedge funds[13] were also partly involved in these transactions as contrarian speculators. In 2001, the nominal value of outstanding CDS contracts reached approximately $1 trillion dollars, and in 2005 it amounted to $10 trillion dollars. For the most part, this increase in CDS volume was due to speculation on the part of contrarian investors and not from actual transactions to hedge loan risk. The bankruptcy of auto parts supplier Delphi stands as a good case in point, whereby $5.2 billion dollars in loans and bonds were hedged by $28 billion dollars in CDS contracts. In 2008, the total value of all outstanding CDS contracts was approximately $62 trillion dollars. The degree of counter-party risk had become impossible to ignore.

After the collapse of Lehman Brothers complete panic broke out. The domino effect was enormous. It was not only that the banks no longer trusted each other or their level of solvency, but rather the entire financial system was called into question leading to worst case scenario. The capital markets collapsed. The banks could no longer refinance or restructure the portfolios effectively. In addition, subprime securities such as corporate bonds were no longer marketable, or could only be sold at greatly reduced value. The consequences for the real economy were immediately apparent.

Lehman Brothers certificates had been sold to investors around the world. Now they were worthless. The media took advantage of the negative publicity by running dramatic headlines leading to widespread fear and uncertainty. In this way they helped to spread the panic. Everyone became convinced of a pending catastrophe and recession, and so reduced their investment and consumption. This became a self-fulfilling prophesy. People became fearful of potentially losing their jobs and stopped spending. As a consequence of reduced liquidity and a shortage of available

[13] In 2000, warnings were issued as to the threat posed to the financial system due to the lack of regulation on Hedge Funds as counter-parties to derivative transactions. See Conrad, Christian/Stahl, Markus (2000).

capital, banks stopped making loans. The "credit crunch" had arrived. The greater economy became fearful of declining sales and liquidity problems and stopped investing. Due to the negative sentiments it came to the classical Keynesian case of underinvestment together with the liquidity-trap. Savers lost faith in banks and withdrew their deposits, which further exacerbated liquidity problems at the banks. In order to generate liquidity, the banks sold shares. Falling market prices lead to even further price declines as risk limits triggered computerized trading and stock sales at many hedge funds. Investment bank Merrill Lynch was taken over by the Bank of America. The US government set up a special fund of $700 billion dollars to buy up the bank's portfolios of non-performing loans. In a form of reverse auction process, banks were permitted to sell their portfolios of non-performing securities to federal funds offering the highest percentage of face value for the securities. The two remaining US investment banks, Goldman Sachs and Morgan Stanley had to give up their previous business model so as to be considered as universal banks and gain access to refinancing funds from the US Federal Reserve. Further access to capital was given to suffering banks by the federal authorities. The world's largest insurer AIG was in-part nationalized through this process. AIG had been speculating as a counter-party to billions of dollars in obligations using CDSs and CDOs following a trading strategy based on the mathematical-statistical model of Yale Professor Gary Gordon. The probability of default as calculated by Gordon proved to be mistaken, however. Further banks were forced into bankruptcy or taken over. Hypo Real Estate in Germany was saved by a combination of private banks and the German federal government. Banks in England and elsewhere had to be nationalized to prevent the collapse of the financial system. Governments came to the rescue of banks through the use of bail-out funds from taxpayers. By this time the world's stock markets had fallen from a peak in August 2007 by more than 50% and set the world on the path to recession. Between March 1st and June 18th 2008, the FBI arrested 406 individuals for loan and mortgage fraud, ranging from small mortgage brokers to bank presidents who were later charged with having deceived investors as to the risks of the subprime market.[14]

As with Enron, Merrill Lynch was insolvent. With approximately $9 billion dollars in losses, Merrill's CEO O'Neal was responsible for the worst financial results at the bank in its 93 year history. And in 2008, there were an additional $15 billion dollars in write-offs. Similar to Skillings at Enron, O'Neal was also possessed of an unusually overbearing management style and obsession with profit results. The consequences would soon become all too apparent. By taking on more risk, O'Neal could produce better profit results while the top management at Merrill cashed in on huge bonuses. At Citigroup, CEO Prince was also facing more than $20 billion dollars in write-offs. Here as well, in 2008 it was necessary to write off huge sums. Both Prince and O'Neal were not only responsible for billions in write-offs, but as senior management received exceptionally handsome compensation packages

[14] See Mayr, Brigitte (2007); Handelsblatt 23.10.08 and 10.1.08, p. 30; Süddeutsche Zeitung 17.11.08, p. 22, Neue Zuricher Zeitung 7.02.08; Zeit Online, 26/2008, p. 24, Der Spiegel, No. 47 (2008), p. 46–79 and Conrad, Christian A. (2010), p. 21.

(Prince received $26 million dollars and O'Neal $48 million dollars in 2006), and a severance package in the $100 million range. O'Neal received about $160 million in cash and stock options while Prince received approximately $100 million.[15] The losses would be assumed by others, namely the shareholders who lost a portion of their investment in the banks while many employees lost their jobs. In other words, not only did the agents of disaster gamble away their investor's money but they were well-rewarded for it. With this disconnect between risk and compensation it's easy to understand why so many bankers took on such huge risks which lead us to today's subprime crisis.[16]

With the crises described above, the general question arises as to what went wrong? What economic dysfunctions are responsible for this huge resource destruction?

4.3 Some Causes of the Financial Crisis

4.3.1 Technical Mistakes

The first serious debate as to the infallibility of the capitalistic economic system arose in 2000 within the framework of the Enron crisis. By 2007, it was obvious that the world economy was in a fundamental crisis with the emergence of the subprime crisis. The subprime crisis was seen as the epitome of the ethical failure of our modern economy. Everything came together and many saw in the crisis the final act of "turbo capitalism",[17] the limitless enrichment of the few at the expense of society, which almost lead to a total collapse of the financial system. The lack of regulation and belief in the self-correcting power of the market was used by a few to take advantage of the situation. Considered historically, financial crises have increased significantly in recent years. This is not the result of simple coincidence, but rather much more an indication of a massive weakness in the present economic system. The market economy has always placed the individual at the forefront for the economic creation of value, which provided him with an ever-growing range of opportunity. Through the pursuit of individual interests, it was believed that this motivation would also create the most beneficial results for society and the greater good. This appears to not be the case. The absence of rules and the belief in the self-healing forces of the markets were exploited by individual to their advantage.

[15] This income was exceeded by Goldman Sachs CEO Henry Paulson, who earned a bonus of $18.7 million along with realizing proceeds from the sale of $480 million in stock by exercising options issued prior to his becoming US secretary of the treasury. See Der Spiegel No. 8 (2009), p. 62.

[16] See also Shiller, Robert (2007); Gold, Gerry/Feldmann, Paul (2007); Muolo, Paul/Padilla, Matthew (2008) and Woods, Thomas E. (2009).

[17] See Dahrendorf, Ralf, (2009).

Could the worst financial crisis since 1929 have been prevented? Naturally, in hindsight it would be easy to answer the question with a "yes", given what we know now about the causes and course of the crisis. Above all, the crisis can be traced back to a violation of market order principles through political intervention. Let's start with the inappropriate involvement of the US government in the financial markets. The crisis started in the early 1990's as a consequence of a misguided social program on the part of politicians. In 1995, Fannie Mae and Freddie Mack received a mandate from the office of Housing and Urban Development (HUD) to lend to subprime borrowers using funds to be provided by HUD at below market interest rates. These funds were to provide mortgages to subprime borrowers in what were considered to be economically disadvantaged social groups, so that they could buy homes that they normally could not afford. The volume of loans and the regulations concerning the classification of subprime loans were increasingly expanded. These cheap loans made it possible for both Fannie Mae and Freddie Mac to boost their profit margins. Executives at Freddie Mac reciprocated with illegal campaign contributions while mortgage lender Connie Wide offered low-interest loans to influential politicians in Washington. One could say the basis for the subprime bubble can be traced back to the US government. It's also worth mentioning that the low interest rate policies of Alan Greenspan played an important role. By making cheap money readily available and supporting deregulation, the Fed created fertile ground for the bubble to grow.[18] One can also blame the US government for an exceptional lack of financial oversight. US financial regulators were aware of the growing problem but chose not to act, so as not to influence competition in the markets.

Rather than acting to regulate and control the mortgage markets, they put their faith in the ability of the market to correct itself and deregulated. This concept had been promoted by Milton Freedman after the Enron crisis. Without regulators, it was possible for companies to hide the risk inherent in these loans from appearing on their balance sheets. Greenspan refused to act to control these new and innovative financial products. Despite the LTCM crisis,[19] Greenspan and the US government remained unconvinced that unregulated speculation by the hedge funds posed as serious threat to the financial system. Many governments, including the German government had been pushing for more regulation. Belief in the markets and the influence of financial lobbyists was more powerful, however. At no point during this phase of the crisis did financial regulators seem to be aware of the combined risk posed by CDOs and how it was spread among the banks.[20] With their complex

[18] See the film "Inside Job" of 2010 by Charles Ferguson (Sony Pictures) and Conrad, Christian, A./ Stahl, Markus (2002).

[19] In 1998 this hedge fund named Long Term Capital Management (LTCM) then lost the investors around 90% of the $4 billion invested, which threatened to trigger a chain reaction on the international finance markets. The issue here is not just the credit taken by LTCM, but also the derivative positions of LTCM as contracting party, with which other finance market actors had protected themselves. Only when the then US central bank president Alan Greenspan intervened personally and pulled together an emergency package of billions from several large banks could the capital market crisis be averted. See Conrad, Christian A. (2005).

[20] "What we have found over the years in the marketplace is that derivatives have been an extraordinarily useful vehicle to transfer risk from those who shouldn't be taking it to those who are

mathematical models and AAA ratings, these deceptively secure financial innovations and the risk that they posed were able to escape the attention of over-worked federal regulators. National regulators, in the case of those in the US were divided and under-manned. At the federal level in the USA there were four uncoordinated regulating authorities and at the state level additional independent authorities. The most powerful authority, the SEC was considerably weakened and unable to deal with the problem due to massive reductions in personnel in their department for risk control and regulation.[21] These cuts in personnel occurred during a time in which a former head of Goldman Sachs acted as the head of the Office for Management and Budget, and while Henry Paulson, the future head of the Treasury department was CEO at Goldman Sachs. Later, the head of the German banking regulatory authority admitted that his office was unable to come to terms with and regulate the rapid developments of these new financial products. Although they were aware of the problems posed by these unregulated financial products, they chose to not intervene. The banks had complete independence of action. Motivated by short-term profits and handsome bonuses, banking managers took on ever greater levels of risk using ever greater amounts of leverage. Many wanted to just get rich quick and gave little thought to the consequences of their actions. This actions lead as well to criminal activity. The most dangerous risk was kept off the balance sheets or allocated to unregulated, hidden off-shore accounts. Also, the level of risk to counter-parties through the use of these innovative financial products seemed to be unknown to the regulating authorities. Due to the excessive use of leverage, many of the hedge funds had also taken on considerable risk. Nonetheless, the hedge funds remained unsupervised.

Paulson seemed to be unaware that the collapse of Lehman Brothers would lead to an unstoppable chain reaction. With the bankruptcy of Lehman, US policy regarding the issue became unpredictable. For the financial markets, it seemed that the Fed was willing to allow for the collapse of some banks, and that an intervention to save those in crisis should not be expected. Market participants completely lost their trust and confidence. Permitting the collapse of Lehman was one of two major mistakes made by Paulson. The other was the failure to change financial accounting requirements for the balance sheet in a timely manner. The mark-to-market regulations concerning CDOs as securities was the main reason for the ongoing write-offs, along with continuous reductions in the value of CDOs due to an almost non-existent market for them. On-going earnings warnings and loss reports strained not only the existing capital of the bank, but also awakened in the mind of the public the perception that a huge, uncontrollable and uncontainable financial catastrophe was occurring. Unfortunately, we will never know how many mortgage loans could have

willing to and are capable of doing so." "We think that it would be a mistake" to more regulate the contracts. Greenspan in front of the Banking Committee in 2003. New York Times, 20.10.2008.

[21] The chief controller of the SEC later spoke at a conference when questioned about "the systematic elimination of personnel from the regulatory office,… so that became impossible for the office to perform any regulation whatsoever." Der Spiegel, No. 47 (2008), p. 78.

been saved from default by quick government intervention, as the opportunity was missed to act quickly to prevent the financial crisis from spreading to the real economy. At least it's certain that if the banks had been permitted to balance the value of their CDO portfolios, taking into account the portion of the securities not affected by bad mortgage loans, the write offs could have been greatly reduced. In consideration of this remaining base value, the banks could apply to the Fed as a "lender of last resort" for refinancing with the CDOs acting as collateral. This funding conversion and extension of debt servicing could have been implemented at the beginning of the crisis, already in the middle of 2007 and not at the end of 2008. The banks and the US administration must have had great interest in keeping mortgage borrowers facing foreclosure in their homes. This could have kept the pressure off of the housing market and home prices. As this did not happen, many borrowers lost their homes and some even ended up living on the streets as the homeless, which raises the question of moral and economic responsibility. Many vacant houses were neglected and others were vandalized.

The banks' trading departments responsible for internal and external credit supervision withdrew their risky long-term loans and refinanced them as short-term securities. Any bank would realize that this was a violation of the golden rule of lending and would have significant consequences. This lack of control, the failure to implement responsible business practices and immoral behaviour deserves critical review. It is beyond comprehension how bankers could be so misled by their statistical and mathematical models, as well as how many could have such unlimited trust in the rating agencies and their recommendations. Despite the ratings assigned by the rating agencies, we can expect senior management planning an investment of billions of dollars to perform at least some degree of due diligence to gain an understanding of the rating agency's procedures. To rely so completely on the judgement of what may be a biased third party is completely irresponsible. In the USA, the dramatic increase in home prices had become impossible to ignore and the easy access to subprime loans was often criticized. Warnings were sounded as to the impending bursting of the real estate and derivatives bubble.

The central problem of derivatives is that the leverage of the invested capital distorts the risk distribution between the speculator and the financial system. If the speculator is wrong he will lose only a portion of what is at stake for the system. The loan derivatives CDS did not have to be funded with equity, so banks earned much more than was appropriate on a risk adjusted basis in the good years. When the bad years came there was no capital to cover the losses so society had to bail out the speculators because they were too big to fail. Bonus payments had been made in the good years and there were no repayments in the bad years, when the bill was presented.

Speculators normally do not speculate against each other, but with each other. A slogan says "the trend is your friend". Only a stable trend facilitates speculation with nearly no risk. The biggest danger of derivatives is the leverage. If futures are used for speculative purposes for instance, the leverage multiplies artificially the effects of the derivatives on prices (via arbitrage and expectations)[22] and does not reflect an underlying real demand or supply. Therefore derivatives can distort the fundamental market functions. As a consequence, the price develops differently as it would normally to cover the needs of demand and supply. The price signals become distorted, which leads to wrong resource allocation. For instance, if prices of commodities like oil become too high because from derivative speculation, it increases the costs for the producing economy and for the consumers. Because of the high commodity prices the commodity sector invests to increase its capacities. The missing demand causes the speculation bubble to burst sooner or later. The new capacities are overcapacities and the commodity sector is in trouble.[23]

The economy worked well without derivatives. Either the risks of derivatives can be controlled or the use of derivatives should be restricted to a mere hedge against risks, their original purpose. An underlying transaction should be compulsory. At least the leverage of the derivatives should be reduced significantly and credit derivatives should be treated like credits so they have to be funded with equity. Otherwise the next financial crisis might be too big for the governments to bail out. The argument that regulations on financial markets cannot be implemented because the world is too divided might be true. Also, the incentive not to regulate is strong, since the free rider position is the most profitable.[24] But also the losses of a possible crisis are too big for each single state. An unregulated financial market is a risk for all other countries. This loss risk has to be paid for to avoid distortion. A tax on financial deals of individual states with unregulated institutions would be the right solution to avoid a free-rider behaviour and it could be implemented by each state individually.

At least the current reforms on banking regulation go in the wrong direction as they increase the equity requirements to cover the systemic risk instead of decreasing the risks of derivatives.[25]

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[22] Empirical studies show that the spot prices follow the future prices. See Deutsche Bundesbank (2006), pp. 59.

[23] For the discussion of the effects of food and commodity speculation see *Conrad, Christian A.* (2014).

[24] Governments find themselves internationally in a dilemma, since the best outcome for a single state is if all other sates regulate their financial market and it is therefore with its unregulated market the most attractive location for financial institutions (Free-rider position). The worst result for the individual state is if it regulates its financial market while the others do not. Since everyone is subject to this situation of insecurity, everyone decides to behave uncooperatively, which provides the worst results for everyone, national and international not regulated financial markets. Such a dilemma is called in the Public Choice Theory "prisoner's dilemma". For the expression "prisoner's dilemma" see *Brennan, G./ Buchanan, James* (1985), p. 3.

[25] See *Conrad, Christian A.* (2014).

4.3.2 Exaggerated Belief in Figures

During her visit of the London School of Economics in November 2008 the British Queen asked: “Why did no one see it coming?”[26]

As the Classic-Neoclassic theory after the Great Depression of 1929, today’s economic theory has explanation and justification problems. Neither of the statistical models foresaw the crisis nor are they now able to explain it. Moreover, the econometric models based on historical figures pretended there was a safety where there wasn’t one, which was itself one reason for the crisis. Nassim Nicholas Taleb wrote about the delusions of control and reliability held by Wall Street and many other businesses. He pointed at the dangers of trusting the “bell-curve” models used by many financial institutions to mitigate risks. He questions the reliance on past historical information and brings the example of the black swan, that nobody expected until its discovery in Australia, or the example of the turkey who spends a thousand days being well-fed before being killed on the thousand-and-first day.[27] Justin Fox also criticises the belief in models and especially the belief in efficient markets – a belief that was qualified by Robert Shiller as the “most remarkable error in the history of economic theory.”[28]

Derivative products such as Collateralized Debt Obligations (CDOs) can be directly traced as being one of the major factors leading to today’s subprime crisis and the greatest financial crisis since the Wall Street crash of 1929. The calculation of risk and value or price for derivatives on the basis of historical time periods was celebrated as a major breakthrough. This advance in financial mathematics was only made possible through the use of the ever more powerful calculating capacity of computers. This made it possible to create many new financial products. It later became apparent that these calculations were in error, and that it was only due to the confidence people had in the ability to calculate them that made these products possible. For example, it was determined that the risk and therefore the price for credit derivatives (Credit Default Swaps) as calculated by Yale Professor Gary Gorton was inaccurate. The confidence and faith in his calculations almost cost AIG its existence and the US government several billion dollars, as it was bailed out to save the financial system in October 2008 and in-part nationalized. Gordon blamed the problem on the use of non-conforming data from the current marketplace and unprecedented developments which deviated from his forecasts based on historical data. But the future is never like the past.

With the model-based statistics, called econometrics in economic science, many connections can be calculated with a great degree of effort and make a grand impression, depending on the sample with its respective probability. It does not matter if there is no real economic sense from these calculations. The senselessness is

[26] See The Financial Times,November 25th 2008. https://www.ft.com/content/50007754-ca35-11dd-93e5-000077b07658

[27] See Taleb, Nassim Nicholas (2007) and Taleb, Nassim Nicholas (2001).

[28] See Fox, Justin (2009) und Conrad, Christian A. (2010), p. 56.

sometimes apparent: "the level of beauty in high schools has an effect on criminal propensity 7–8 years later."[29] In 1929, Yule found a correlation of 0.95 between the ratio of marriages in the Church of England to all marriages and the death rate for the years 1866 to 1911. Henry developed was he later jokingly referred to as a new theory of inflation in 1980, in which he showed the correlation between rainfall in the UK and development of price levels.[30]

The obviously false conclusions of these models are much more dangerous, however. They can originate in a sequence of numbers that lead to false correlations, incorrect model assumptions or unrealistic model constructions, or just forgotten factors of influence. These weaknesses can also have mathematical model constructions. Here is one example from the German economic newspaper Handelsblatt about economic models.[31]

> "Economists show with a theoretical model that it can make sense for a company owner to do without strict controls on managers. When a manager is constantly kept under watch his risk of losing his job increases. He must also give up some of his authority. In compensation he demands more money and is tempted to manipulate his information to the supervisory board." [Authors of the model: Benjamin Hermalin (University of California) and Michael Weisbach (University of Illinois)[32]]

Let us discuss the logical content of this model. Too strict of controls (whatever that means) is not possible unless the company owners follow a manager's every move. Controls per se have nothing to do with a manager's risk of losing his position unless the manager is bent on cheating the company. The authors of this model also assume that managers are bad people in principle. Why else would they assume that managers would react to controls by manipulating information? Manipulation of company information in such a case is not created by the controls, it is made more difficult. Why should the "bad" managers demand the maximum salary independent of their authority? It is more likely that managers find it easier to obtain advantages (salary and other benefits) when they are controlled less.

In addition, the results can be influenced not only in the selection of assumptions, but also through the construction of the models, but this is not obvious to non-statisticians, such as journalists.[33] Other researchers have simply miscalculated. Results may be considered scientifically proven for years if other researchers do not decide to follow the calculations in detail, which would otherwise have made the errors known. Harvard professor Martin Feldstein showed in 1974 in the renowned "Journal of Political Economy" that the increases in social benefits in the USA since 1937 had displaced the tendency to save money in private persons. Six years later

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[29] See Mocan, Naci/Tekin, Erdal (2006) and Fedako, Jim (2007), Correlating nonsense, **February 18, 2007,** http://antipositivist.blogspot.com

[30] See Zorita, E. (2006).

[31] Handelsblatt dated 04/03/06, p. 11, translated into English.

[32] See Hermalin, Benjamin E./Weisbach, Michael p. (2007), pp. 1–26.

[33] Anyone who would like to see an example of this can take a look at the website http://timlambert.org/2003/09/0910/. Here the author of a statistical model proving that broad ownership of guns leads to less crime is accused of manipulation.

Dean Leimer and Selig Lesnoy showed that Feldstein had miscalculated.[34] The thesis from Levitt and Donohue from 2001 suffered a similar fate. They had said that the main reason for a drop in criminality rates in USA since the early 1990s was the legalization of abortion in 1973. They maintained that unwanted children are raised in conditions that increase the probability that they will become criminals. Four years after the publication in the renowned Quarterly Journal of Economics, in 2005, two economists of the Federal Reserve Bank of Boston discovered their mistaken calculations.[35]

The worst thing about mathematics is that it almost always provides exact and clear results, thus proof, based on the model assumptions and design. Business science seems to have given in to the same temptation as economic science with the increasing popularity of financial mathematics. Numbers are facts. This is not economic reality however, since people make up the economy. People do not always act rationally; they are in fact often emotional and sometimes wrong. “Figures are facts, but people are not.” Economic science cannot be an exact, deterministic natural science, but a social science. Including irrational behavior in model does not change the incalculable nature. There is a good reason why the economists often argue in public over the best method, which encourages some people to participate even if they have no background in economics. The progress made in academics through economic science and progress applicable in practice has been very slight in comparison to the natural sciences. It is very difficult to objectively evaluate the value of research contributions in a social science. Alfred Nobel most likely considered economic science as part of the social sciences, and therefore did not make a separate prize for it. The prize often called the Nobel Prize for Economics, awarded at the same time as the Nobel Prize, is from the Swedish National Bank. The attempt by economics to conduct experiments like those in the natural sciences at great expense have failed through their lack of comparability between situations, and the interchangeability of actors. Let us remember that the innumerable environmental influences that are constantly changing and the incalculable factor of humans only allow the identification of economic development trends. Hayek recognized this, and said that only pattern predictions can be seriously considered.[36] The future us never like the past. National economies and companies are not calculable. In the best case central factors such as money, and conditions such as state and competition can be observed and regulated, but the rest happens of its own accord through the human productive forces. We don’t need so many calculations for this, it is sufficient to train and educate the humans so that they can work within the framework (economic

[34] “This paper uses an extended life-cycle model to analyse the impact of social security on the individual’s simultaneous decision about retirement and saving Economic evidence, using an estimated time series of “social security wealth,” indicates that social security depresses personal savings by 30–50%.” Feldstein, Martin (1974), p. 90.

[35] “We offer evidence that legalized abortion has contributed significantly to recent crime reductions” Donohue, John J./Levitt, Steven D. (2001), p. 379 see also Handelsblatt dated 04/30/07, p. 9.

[36] See Hayek, Friedrich August von (1974).

order) with the right incentives, and to structure the framework so that the human productive forces can develop for the good of the community.

It is difficult to understand why such an over-confidence in these calculations endured for so long, finally resulting in the subprime crisis, although the LTCM crisis had already illustrated the dangers and weaknesses of these financial calculations. In 2005 there were already warnings against using models for financial calculations based on historical figures.[37] The best example for the incalculability of the economy are the formulas for option prices (Black & Schools-Formel) which were responsible for the LTCM-crisis. Robert Merton, Myron Scholes and Fischer Black received the Nobel Prize in 1997 for groundbreaking work in Option Pricing Theory. Based on the volatilities of the past, the formulas were developed to calculate prices for rights to sell or buy assets in the future (options). This is apparently an instrument to calculate the future. A hedge fund named Long Term Capital Management (LTCM) wanted to use for speculation, and he hired Robert Merton as a consultant. In 1998 LTCM then lost the investors around 90% of the $4 billion invested, which threatened to trigger a chain reaction on the international finance markets. The issue here is not just the credit taken by LTCM, but also the derivative positions of LTCM as contracting party, with which other finance market actors had protected themselves. Only when the then US central bank president Alan Greenspan intervened personally and pulled together an emergency package of billions from several large banks could the capital market crisis be averted. The second of the hedge funds Merton consulted, named IFC Continuum, closed in 2006. The future was in fact not predictable.[38]

The flaw in the option price theory or risk values such as "value of risk" which were determined on the basis of historical volatility was that future relationships between demand and supply could not fundamentally be accurately depicted. This is how in 2008 Porsche could raise its stake in VW to 74% through the purchase of VW call options, at a much reduced price than if it had bought the shares on the open market. The option price for VW shares did not reflect the actual shortage of shares, which had been calculated on the basis of past price volatility. This miscalculation lead to the share prices being set much too low. The excessive demand for VW shares eventually lead to a short squeeze.

The use of the same seemingly correct risk models led also to a similar investing behavior of the market participants. If the models were wrong all investors came to the same wrong risk assessment, what worsened the subprime crisis. Also the rating agencies used the wrong models to calculate their CDO-ratings. Based on these wrong ratings the investors underestimated the risks substantially and decided all to invest. Therefore the risk models increased the systemic risk and did not decrease it.

Abstract and isolated models of thought are fine in principle. They make it possible to take the complex economy apart into separate connections and thus to allow discoveries about economic processes. Econometrics is thus a valuable ancillary

[37] "The method of calculation is based upon historic volatility and does not take into account irrational human behaviour, such as panic,…."Conrad, Christian A. (2005), p. 398.

[38] See Conrad, Christian (2005) and Welt-Kompakt dated 08/22/06, p. 15.

science for economics. There is also nothing to be said against using mathematics, as long as the effort remains proportional to the usefulness of knowledge gained. The models have unfortunately become so complex however, that they are no longer useful for teaching purposes. The effort required to learn them is greater than the knowledge gained. It is problematic when econometrics, thus the statistics applied to the economy with economic mathematics, are taught as exclusive representation of the only true economics. Without order theory and order politics of order there can be no understanding of the state and economics.

Derivatives as the so called Collateral Dept Obligations were the trigger and the main reason for the subprime crisis. They are based on complex economic modelling and statistics. Basically we can say that the image of the economy is distorted when only determinist models are applied. More thinking and less calculating would have been much more appropriate. So can the subprime crisis can also be traced back to developments in the economic sciences.

Be that as it may, econometrics, statistics and mathematics have contributed significantly to the continued development of economic science. They deserve recognition, no doubt, but this is no reason for economic science to consist solely of these subjects. At the end of the scientific chain there must be somebody to explain the science of practice and weigh the various theories and approaches against one another on the basis of practical considerations in order to make statements relevant to practices in a comprehensive economic overview. To make statements relevant for practical application the theories and models must be related to the respective practical situation. Only then is it possible to decide what parts of the respective models of thought can be applied. In this highest of disciplines, the relation exists both in theory and in practice, at least within economic science. This requires an analytic, combining intelligence. The considerations must be logically deductive and verbal, since there is no calculability of the economy as a whole. In economic science as a social science mathematic abilities are less important, and the creative approaches to explanation gain importance.

4.3.3 Missing Moral Values

The enrichment of managers at the expense of their company and the society was criticized long before the subprime crisis. A scandal is really nothing more than immoral conduct in the eyes of society. Whether we look at top managers just trying to get the most out of the company they have been entrusted with, or manipulating the balance sheets to get rich with stock options or bonus payments at the expense of clueless stockholders, or employees lower down in the hierarchy who try to cheat their colleagues or the market, we are looking at proof that across the globe the economy has to wrest with massive ethical problems. It is worth noting that even model companies, such as Enron, are affected by moral lapses. There are many US companies, as well as internationally known investment banks such as Merrill Lynch, Morgan Stanley and Credit Swiss First Boston in the USA and Goldman

Sachs, Morgan Stanley and Deutsche Bank in Germany, who have all been accused of stock analyses advocating sales.[39]

The largest bank in the world and the American branch leader Citigroup seems to have had ethical problems as well. The Citygroup head Charles Price addressed his employees with these words: "No one may damage our long-term interests for short-term advantages." He said he would check into "unnecessary risks and unethical behavior" personally if necessary.[40] He prescribed ethics seminars for his employees and had a behavioral code drawn up, and established a department where the employees could anonymously inform the company of unethical behavior. What happened? His predecessor Sandy Weill had set the employees a growth rate target of 15% and seems to have implemented it absolutely. The pressure was apparently so great that the employees, voluntarily or involuntarily, turned to illegal methods to reach the targets. The bank was then only able to avoid lawsuits and the subsequent damage to its image by agreeing to pay out settlements, connected with damage compensation. In .2002 it paid $400 million because Citi analysts portrayed stocks too positively, which Citi investment banking wanted to sell. In 2004 the Citigroup paid $2.65 billion for Worldcom and $70 million to the US Federal Reserve after being accused of lending usury credit and giving credit only in connection with the sale of superfluous insurance. Another accusation was that the bank did not pass on rebates to the customers of their investment funds. In 2004 Citygroup lost their license for private banking in Japan because of abuses of the law against money laundering and market manipulation. In 2005 the US bank supervision forbid Citigroup from any new takeovers until internal rules of ethics had been implemented. In 2005 there were also settlements paid for involvement in the bankruptcies of Global Crossing ($75 million) and Enron ($2 billion). There was also a 4 million British Pound settlement and returned profits of 9.96 million British Pounds for manipulated prices on the London bond market. These are of course just the ethical missteps that were brought to light.[41]

It seems conspicuous that those firms which for years seemed to be among the most financially stable would wind up in a state of collapse. This is valid for Enron and other firms as well as for Citigroup and the investment banks involved in the subprime crisis. But this is true only in the short term. Long term these firms had financial problems.

The subprime crisis can be considered the epitome of the ethical failure of our modern economy. Everything came together, and many saw in the crisis the final act of our "turbo capitalism", the limitless enrichment of the few at the expense of society, which almost lead to a total collapse of the financial system.[42] The lack of regulation and belief in the self-correcting power of the market was used by a few to take advantage of the situation. The victims were, above all, the socially and economically disadvantaged who were convinced by predatory lenders to buy homes that

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[39] See Chediak, Felipe/Escudero, Silvio (2004), p. 79 and Ogger, Günther (2001), pp. 103.

[40] Quoted from Capital, 18/2005, p. 54.

[41] See Wirtschaftswoche dated September, 01, 2005, p. 52–58 and Capital, No. 18, 2005, p. 54–56.

[42] See Dahrendorf, Ralf, (2009).

they could ill-afford and which would lead them to personal bankruptcy, or at worst, homelessness and a life on the streets. This was truly the creation of social misery. Mortgage lenders had to be aware of this, as they were directly involved in working with the subprime borrowers most at risk of default, which should be considered the height of moral irresponsibility. These lenders only gave thought to their personal profit without any consideration for the fate of borrowers. In the end, they were rewarded on the basis of their success in issuing loans. The difficulties that these borrowers would have in repaying these loans were of no consequence to them. For the most part, these borrowers did not have the education or the capacity to understand the nuances of how their mortgages were structured, and lacked the protection of appropriate consumer agencies or law enforcement. All those who knowingly took part in this deception and intentionally inflicted this suffering on unsuspecting borrowers are morally culpable. The Clinton and Bush administrations who encouraged lending to subprime borrowers through Fannie Mae and Freddie Mac as part of an ill-conceived social program are also in-part responsible. Also culpable are those who knowingly encouraged this process and profited from the housing and mortgage bubble while helping to finance the ensuing social misery. Noteworthy here are also those bank managers who knowingly gambled with the long-term viability of their banks and the financial system so that they could maximize their profits and bonuses over the short-term. The moral responsibility lies with the financial regulating authorities who tolerated the creation and growth of the real estate bubble and the spread of subprime mortgage products that made it possible. They permitted the creation of a new, unregulated credit market without intervening. In the USA, there were wide-spread and timely warnings concerning the dangers of a bubble in the real estate, the subprime mortgages and financial innovations that made it all possible.

In light of the business crises, it is no wonder that societal recognition for managers has dropped to the current low, which the manager's guild should be taking to heart. In a Wall Street Journal survey in 2003, 64% of those questioned said that they do not trust managers. This result was only trumped by one other profession. Only 16% of those questioned trusted politicians, and 84% expressed distrust.[43] Other studies determined that managers in the USA and Germany to have a very utilitarian attitude on ethical and moral questions, in particularly among young managers and American economic students. Typical statements included "One has to look after one's own interests," "Morality is just a matter of feelings," or "Sometimes small injustices are necessary in order to reach greater goals."[44] According to a survey among Swiss managers, 75% assume that the market forces automatically provide for an ethically and morally justifiable behavior.[45] It is interesting to note that many managers do not seem to feel comfortable with immoral,

[43] See Ergenzinger, Rudolf/Krulis-Randa, Jan S. (2004), p. 4.

[44] See Noll, Bernd (2002), p. 168.

[45] See Ulrich, Peter (1993), pp. 1173 and Ulrich, Peter (1993), pp. 1172.

unethical conditions. Studies have shown that meanwhile the majority of managers go to work with more or less consciously felt fear.[46]

Studies had already established a very egoistic attitude among American business students in the late 1980s. The behavior is purposeful and opportunistic. Moral reflexivity is severely restricted. Success and continuity are unconditionally the first priority. Typical words are "winning is everything".[47] According to a survey among Swiss executives, 75% of managers assume that the market forces automatically provide ethically and morally justified behavior. Another survey among German executives comes to a similar conclusion, inasmuch as 50% assume that their company automatically contributes to the common good through its activities.[48]

According to a survey by GFK market research from 2008, 61% of Germans asked were of the opinion – that sincerity and honesty does not pay – the world is dishonest and people expect to be lied to. And 38% consider it appropriate to lie if it will advance their career.[49]

Ethical problems are increasingly making things more difficult for companies as an internal problem of loyalty. In a study conducted by the German personnel consultation firm Kienbaum, Human Resources managers complain about a generation of applicants with little inclination to fully engage themselves. Nearly every other Head of Human Resources bemoans a lack of social competence. Young people increasingly act to maximize their own benefits. This means, for example, that when they have a question to answer, they consider what answer will be the most advantageous. This generation of streamlined opportunists does not please personnel, because they neither provide the necessary creative input, nor can their supervisors trust them. "The question of what one actually wants to do in five years can hardly be answered. Personnel employees know that employees and companies no longer enter a bond for life. But enthusiasm for a task and the desire of the applicant to do something special is still important to the companies."[50] According to Walter Jachmann, Manager of Human Resources consulting at German Kienbaum, applicants lack backbone and personality:

> "Exactly at the time of crisis the company leaders do not get the information they need. No one discusses or contradicts, because everyone just nods and follows the managers"[51]

The internal and external selection process are also criticized, however. Assessment centers make Human Resources' job easier when evaluating a large number of applicants according to objective criteria in a relatively short amount of time. The tests can be prepared for in advance though, and in order to be successful

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[46] See Noll, Bernd (2002), p. 168.

[47] See Löhr, A. (1997), p. 198.

[48] See Ulrich, Peter (1993), pp. 1172.

[49] See Rheinische Post, 04/18/08 and http://de.statista.com/statistik/daten/studie/292/umfrage

[50] Walter Jachmann, Manager of Personnel Consultants Kienbaum, quoted from Handelsblatt dated October 20/21/22 2006, p. 1.

[51] Stefan Tilk, Member of Management at the Bertelsmann subsidiary Arvato Direct Services, quoted from Handelsblatt dated October 20/21/22 2006, p. 1, translated into English.

the candidates must optimize their answers according to predetermined criteria. In these mass tests there is no room for the rough edges of a creative personality. The internal selection processes often reward conformity, making contradiction an unattractive option.[52]

Against the backdrop of corporate crises, it is not surprising that the social recognition of managers has declined considerably in recent years. In a Wall Street Journal survey in 2003, 64% of respondents said they would not trust managers. This result was only surpassed by a profession. Politicians only 16% of the interviewees, 84% expressed their mistrust.[53] In the US, in a survey, only 13% of respondents said they trusted the managers of large corporations.[54]

In the meantime, the notion that honesty is stupidity has apparently prevailed not only in the economy, but also across society. It is often said that "morality must be able to be afforded." Everyone is his own best friend. Communion and sacrifice are replaced by ruthless utility maximization. According to a survey of CSF market research conducted in 2008, 61% of the Germans surveyed felt that sincerity did not pay off - the world was finally lied to. And 38% thought it would be justifiable to lie if it served their own career.[55]

It is interesting that many managers in immoral unethical conditions do not seem to be able to lie. Studies show that the majority of executives now have more or less consciously felt anxiety at work. The fear of job loss, the fear of making mistakes and the fear of misinformation are dominant here.[56] Fear at the workplace, exaggerated performance pressure and interpersonal competition pressure play an important role in mental illness.[57]

The behavior of bankers did not change significantly after the financial crisis. In 2013, only 36% of Wall Street employees surveyed believed their industry had changed for the better. On the other hand, 52% were convinced that the competition was involved in "illegal or unethical" actions. This information was answered by nearly a quarter of respondents in the "own house experienced" or "first hand" experienced. However, 29% considered unethical or illegal tricks "to be successful," an increase of 17% over 2012 when the study was first conducted. Particularly in the case of younger employees, an ethical attitude seems to be lacking. 36% of young bankers with less than 10 years of experience advocated windy tricks, versus 18% of Wall Street veterans with more than 20 professional years. A quarter would be ready for insider trading "if they could earn at least ten million dollars." In the case of the younger colleague, this share even rises to 38%. 17% are convinced "that their bosses look away if they suspect a top performer of insider trading." This is justified by the fact that the income is too low: 26% think that the remuneration

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[52] See Handelsblatt dated October 20/21/22 2006, p. 1.

[53] See Ergenzinger, Rudolf/Krulis-Randa, Jan p. (2004), p. 4.

[54] See Brown, M. E./Treviño, L. K. (2006), p. 608.

[55] See Rheinische Post, 04/18/08 and http://de.statista.com/statistik/daten/studie/292/umfrage (01/22/2010).

[56] See Volk, Hartmut (2000), p. 57.

[57] See Volk, Hartmut (2006).

plans or bonus structures of their companies are an incentive to betray ethical norms or break the law. This is the case for the younger 31% and the older 21%.[58]

The managers are thus not fulfilling their role model function. The internal company contract for the distribution of work, stress and income is turned upside down, which is rightly felt to be unfair, thus has negative effects on the other employees.

4.4 Summary

As we have seen unmoral aspiration for enrichment of managers was common in all crisis. People are influenced in their behavior by their view of the world. Ideas and attitudes, or moral values, must be shown by example and included in education.

Bad examples can ruin common decency as much as it can be dangerous to continually preach thinking in models and maximizing benefit as the only reasonable, rational behavior. The consequence will be that people orient themselves on these behavioral maxims and repress their positive human characteristics such as sympathy, helpfulness, general willingness to sacrifice and selflessness. Management education in particular must ask itself if it did not indirectly create monster managers; business ethics receives too little attention.

Comprehension Questions

1. Name some causes of the Enron crisis.
2. Name some causes of the financial crisis.
3. What are the common moral causes of economic crisis.
4. Can you imagine some reasons for the unethical atitude of the managers.

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[58] See Sucharow, Labaton (2013).

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Chapter 5
Market and Morality

What Follows Why?
To what extent does the market exhibit moral and ethical behavior? Are the results of the market moral and what are the effects of so-called market failures? The market as a framework and a place for economic action will be analyzed in the following chapter, and profit and property will be examined for their morality. What is the system as a whole? Which rules apply in the so-called market economy? And what does market economy have to do with morality? Or in other words, do market forces promote moral ethics or hinder them? We will address these questions in the following.

Learning Goals
You should be able to explain in their own words the extent to which morality complements the market functions.

5.1 Economy and Freedom – A Historical Overview

What did economy and society look like a few hundred years ago? In the middle ages the economic and social form of organization was feudalism. These two forms were interdependent even then, whereby the technological-economic developments determined the social. The societies that adapted to these new developments applied the technological progress and the subsequent productivity advantages the best.

In feudalism the society was hierarchically centrally organized corresponding to the economic structure. The economy was particularly determined by the agrarian sector. Simple tasks were required for agriculture and the distribution of labor was slight. There were few products that had to be produced. The simple tasks to be executed were easy to supervise. Whether or not laborer picked the fields was easy to see. The aristocracy and the church had power concentrated in their hands. The prince assured internal order and external security and there was no separation of

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powers. Legislative and executive powers were held by the same person. The individual had to subjugate himself and submit. In the towns the people were unconditionally at the mercy of the prince. In addition to the harsh early rules of the prince, there were also strict moral rules from the church. The punishment for disobedience could reach all the way to eternal hellfire. Life for people at that time was very constricted, there was hardly any individual freedom. The fact that these societal structures were determined by the economy is clear in the saying at the time that "city air makes you free by year and day."[1]

In the so-called free cities it was at least possible to work as an independent handyman or salesman, allowing a certain amount of self-determination in life. The amount possible was determined by the guilds, the self-government of the cities. The guilds embodied the economic order of the time. Within their framework the individual could move freely, be active in the guilds and even participate in determining the city policies depending on one's fortune, such as in a city council. The cities were created with the development of differentiate crafts and the blossoming of trade. Later the manufacturers came and with them a new economic level with the corresponding power. The level of welfare that could then be obtained created power, which the princes repeatedly tried to obtain for themselves over the next few centuries, but which they never could. On the contrary, the new bourgeoisie demanded with the economic power increasing distribution of power in feudalism and ended up stripping the power of aristocracy.[2] The technology determined the economy, and the economy determined the society.

The economy continued to develop. With technological progress people were increasingly replaced by machines for simple tasks. The people were needed for planning, building and operating. Fewer and fewer people were needed in agriculture. The labor saved by technological progress could then be used to produce new products, which increased the general welfare or could be used as leisure time. The time this freed up allowed a broad populace to achieve a basic education. With the shift in the national economic production from agriculture to the continual industrial manufacturing of new goods, the rules of a market economy gained new importance. Whereas the agricultural system allowed centralized, top-down planning, implementation and supervision, more complex production of an increasing number of goods had to be coordinated. This was only possible through the decentralized price mechanism of the market. More and more markets for more and more products and preliminary products were created and controlled the production, sales, investment and consumption plans of people. The structure of the products and thus their production process were increasingly complex, and the variety of products increased as well. Thus the distribution of labor and specialization also increased. This trend is very visible in new training and study courses.

The tendency towards more complex structures demanded an increasing level of self-responsible behavior from people, thus an increasing level of freedom. The strong incorporation of the individual in the village community and extended family

[1] See Mitteis, Heinrich (1976) and Hühns, Erik/Hühns, Ingeborg (1963), pp.123.

[2] See Schäfer, Michael (2009).

as well as the subjugation to the power of the prince and the church were replaced over time with more freedom for the individual. After the industrial revolution the service sector rose to the fore, and then came the computer age, which brought new demands for the people in the economic process once again. The tendency moved away from physical activities towards metal activities. If there were still many simple tasks in industry before the computer age, now the manufacturing robots have taken over the simple assembly line jobs. The machines were mostly controlled by calculating machines, the computers. With the progressing industrialization not only the market economy but also the individual had a completely different value. The actions that were simple for supervisors to control, within the hierarchy, became fewer, while being a self-starter and having self-responsibility became more important. The computer age increased this trend. The companies had to grant their employees more space and responsibility. The strictly hierarchical control through supervision of the employees was not as well-suited to assure optimal manufacturing processes. Instead, the companies increasingly turned to setting targets and a sliding scale for wages. Technical progress determined the economic and thus the political development. Thus if an economic system of market and competitive freedom is to function with the level of technology we have today, the individual must be free. A system that tries to separate economic from political freedom will not last, as history as shown. Over the long term economic power has always acquired political power. In the end the economic power makes decisions about the options to politically assert itself. This applies to countries as well. Economically developing countries have always demanded political power abroad over the long or short term. One could compare the foreign policy power of the USA now with 200 years ago.

The decentralized economic activity of the market economy on the other hand, has remained just as important, with a high level of individual freedom. This is why democracy and market economies are interdependent, since democracy promises the maximum possible political influence for the individual as a form of political freedom. For a modern market economy system to function the individual must be free. Technological development determines the economic structure, which in turn determines the societal structure. The stages of economic development and the political system are interdependent if the strengths of the respective economic system are to be realized.

The agrarian sector does not need the individuals involved to develop independently. A feudalistic social system is thus possible and fitting for the organizational needs. Cultivation of fields can be planned and controlled centrally. The optimal economic system appropriate for the modern production technology is the market economy and the appropriate political system is democracy. A centralized, dictatorial system would be contradictory. Considering this the USSR could never have won the arms race because the political system did not fit the economic requirements of the second half of the twentieth century. It was destined to lose for evolutionary reasons. This does not necessarily mean that the society must unconditionally subordinate itself to the economy. The law of economy must be used for the good of humanity, just like the law of nature. Freedom is connected to the possibility for individuals to gain property through their performance in the market. Owning property is the central motivation in a market economy, although it also contains the respective power of disposal over the resources and thus rights and power.

Market economy needs self-determined entrepreneurs as a personality type, like Schumpeter's pioneer entrepreneur.[3] This type of person must be able to develop freely. It is not sufficient to liberate those who are not free. When people grow up in bondage of any kind, no one can expect them to behave creatively and self-responsibly when they suddenly gain freedom. Even if people have a basic tendency to be entrepreneurial, they must reorient themselves to the new freedom and the new market system. Experience in a market economy is only gained through trial and error, which needs time.

The tendency towards the separation of the individual from society induced through technology, thus the tendency towards increasing freedom of the individual from social constraints, still exists. The enlightenment with its freedom and participation demands the consequences resulting from the technological developments that have changed economic and social structures. The consequent application of the market economy rules is also the consequence of the optimal adaptation to the predetermined technical conditions.

How does this tendency affect individual freedom?

In 1989, Kerber found that the young leaders were inclined to opportunism and accepted immoral and often criminal behavior when material success was achieved. Slogans like "Everyone is the next one", "One hand washes the other" or "To achieve a higher goal, sometimes wrong can not be circumvented" were popular. Kerber summarized the trend as follows:

> The tendency seems to be a stronger ego-orientation and more attention to success, material goods and enjoyment.[4]

At the beginning of the 1990s there was a trend away from duties such as order, discipline, loyalty, thoroughness and reliability to so-called unfolding values such as independence, self-responsibility, participation and creativity.[5]

A tendency towards individualization has been confirmed by the consulting company Hay Group – in a joint study ("Leadership-2030") with the company Z-Punkt. They also refer to the impact on employee motivation:

> Individualization has a strong impact on the loyalty and willingness of employees, who often attach greater importance to 'soft factors' such as recognition, self-development, self-responsibility, value-driven commitment and work-life balance than traditional factors such as payment and promotion.[6]

Many authors see the way into the "post-material evolutionary development" not only positively. They point out that a society can not exist without obligations.

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[3] See Schumpeter, Joseph Alois (1911).

[4] Kerber, Walter p. J. (1989), p. 280.

[5] See Dahm, Karl-Wilhelm (1993), p. 4 f.

[6] See Hay-Group (2011), p. 8.

Many problems cannot not be solved through self-realization, pleasure, and embarrassment, but would only be talked away.[7]

In modern free society everyone should have the opportunity to develop as he wishes. Everyone should at least have the chance to work their way up to become a millionaire, which is the central stimulus of the market economy. According to the Enlightenment, all human beings are at least equal to their basic rights, which is why a problem-solving approach suggests that the freedom of the individual ceases where the other begins. If left aside, this would be a very idealistic illusion which would lead neither to a functioning nor a humane society. There were only individualists who would maximize their usefulness, their freedom within the boundaries defined by the rights of others. A society as a coherent whole, a community would not exist. No one would do something useful, something charitable, for others. No one would sacrifice himself for his family, no one would nurture or support his parents in old age, or strive to educate his children. Socially necessary honorary offices would no longer be accepted. Politicians would only use their offices to maximize their own benefit. For the benefit of the community, society, the state, or the nation, no one would stand.

Conclusion and Summary

The view that honesty is stupidity seems not only to have established itself in the economy, but throughout the society. "You have to be able to afford morality" and "you have to watch out for your own," are common phrases. Public spirit and a willingness to make sacrifices have been replaced by a thoughtless benefit maximization. Social education is subject to variations, which we called zeitgeist. If there were ideologies at the beginning of the twentieth century that demanded self-sacrifice for the supposed general good, today the individual and its benefit maximization is the dominant idea. People had the same predispositions over the past few centuries as they do today. Immorality was always rife, and after a time a cultivated civilization developed morally, then often fell back into the middle ages.[8] Still, there were other, more moral times and societies. How can these moral changes be explained? Morality is above all a social problem, and has always been so, at least since people have been dependent on one another in groups. The church had a monopoly on interpreting morality for the last 2000 years, or at least until the enlightenment. Whether the result was morally irreproachable is another issue. According to Immanuel Kant, enlightenment is a person leaving the nonage they themselves are responsible for. This sounds well enough, like freedom and escaping moral slavery, but it is also like a second expulsion from the Garden of Eden. A shortcoming of the modern age is that people are left to their own conscience, and must make the choice between good and evil on their own. It is the "you mayest" of the American author John Steinbeck, who expresses the ability to choose even as the meaning of life. For an average person this balancing act between good and evil is

[7] See Leisinger, Klaus M. (1997), p. 144.

[8] Such as in Germany during the time of National Socialism

almost impossible without help from outside. Leaving the self-imposed nonage has led to a certain loss of orientation.

This disorientation is not unproblematic. It is probably the tree of knowledge in fact, from which Adam and Eve ate the apple. They can distinguish between good and bad actions, which means they have the fundamental aptitude of conscience. The right path is not handed to people without their own effort, however. They must work for it, or to put it another way, people are not born good, but they can improve. This can take place internally through increasing mental maturity or externally. This phenomenon is called socialization, and is the forming of human behavior patterns through rewards or negative sanctions and role models. We could also call this one's upbringing. Parents are not the only ones to educate their children, rather the whole society influences people through these mechanisms.

On the way to total freedom, more and more rules and norms are abandoned, more and more taboos are broken. This trend, however, should be questioned by society, because it is also a way to total individualism. Does this route offer more advantages than disadvantages for society? Does the trend have to be steered into the socially desired pathways? It becomes clear that due to the technically driven economic and social changes, we can assume less and less duty ethics combined with social control. To this extent, we agree to the statement of Homann, but we arrive at other conclusions than the moral economy. It must be the other way round: the greater the freedom of the individual, the greater the morality of man. If the prince and the church no longer sanction men for moral misconduct, if there are little or no pre-determined rules, then the individual must have internalized the socially desirable behavior by inner values, so called ethos. The more modern the economy is, the more important are morality and values for the development of the productive forces.[9]

A total state control of human behavior is both impossible and undesirable, because individual behavioral freedom should be abandoned. This also applies to the control of employees in companies. This gap must close moral, ethical behavior, and business ethics also applies to the economic sector. It has to influence the behavior of the people in the economy in such a way that the company productivity and the common good are maximized.

In conclusion, many authors point to a tendency towards individualism and materialism. It is a question of a "change in values", a neglect of the classical class and profession ethos, as well as an erosion of traditional values such as honesty, justice and solidarity.[10] In the following, we will ask ourselves what business ethics can change in this environment.

Comprehension Questions

1. What is meant by so-called individualization?
2. What are the reasons for this?
3. What is the significance of this development for business ethics?

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[9] See auch Dahm, Karl-Wilhelm (1993), p. 8.

[10] See Pritzl, Rupert F. J./Schneider, Friedrich (1999), p. 327.

5.2 A Free-Market Without Social Rules?

An extreme free-market orthodoxy is considered as one of the causes for the subprime crisis. A spoke word of the investment bankers is "rules are for fools". Greenspan and many U.S. politicians such as Reagan were against rules for the economy. Rather, they wanted to unleash the market forces in order to create more growth. Continental Europe, however, demanded stronger regulation of financial markets. The reason are different conceptions of economics. As Fox points out:

> Europeans tend to be less hostile to government as regulator and more sceptical of private cooperation as servant of the public interest.[11]

In Continental Europe the most spread economic concept is the Ordoliberalism. It does not share the optimism that the market would develop perfectly without state intervention, however, since it might be in the interest of companies to rid themselves of irksome competition, such as price agreements, mergers, vertical restraints etc., and secure profits through a monopoly.[12] The individual freedom in the market is a competition policy goal for ordoliberalism inasmuch as the assumption holds that companies will try to abuse their freedom at the cost of others within competition processes.[13] Thus a strong state is necessary to channel the behavior of market participants through laws and prevent or remove restrictions to competition through intervention.

Adam Smith was aware that the invisible hand alone is not sufficient to protect the common good from damage by individuals. He stressed the necessity of an economic system and a system to keep order, which did not exclude intervention to protect the common good. An individual enrichment at the cost of the common good cannot be tolerated by a society for several reasons. Besides the damage that is done to the national economy, such behavior has a degenerative effect on the system. Only if the legal system functions well and there is "trust in the sovereignty of the state" can trade on markets develop to the advantage of people, according and create welfare. Smith also identifies the most important components of order to be internal security, jurisprudence, infrastructure, educational institutions and national defense.[14] Adam Smith had already differentiated between an economy and an economic system. The economic system must set the framework for economic behavior in such a way that the invisible hand of the market and competition can develop optimally, meaning that the actions of people determined by their own interests are channeled for the common good. The economic system has the task of setting and implementing the rules for competition and the markets. Adam Smith was thus the first theoretician of order. Unfortunately he did not analyze the importance of the framework for economic order in depth.

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[11] See *Fox, Eleanor M.* (2006), p. 983.

[12] See Starbatty, Joachim (1983), pp. 570.

[13] See *Starbatty, Joachim* (1983), p. 569 and *Hildebrand, Doris* (2002), p. 160.

[14] See Smith, Adam (1776), chapter III, first paragraph.

The opposite view is represented for instance by Milton Friedman. An extreme belief in the market is expressed for instance in the answer Friedman gave in reaction to the balance sheet scandal in the USA at the beginning of this decade. He said, "Don't do anything, the market will regulate itself!"[15] Is that really the case?

Is it possible that a society develops without any social values, democratic knowledge and economic knowledge? If we are looking for an example to analyze this question we can look at Russia. There can hardly be a more fascinating country than Russia, an empire that determined world politics in the last few decades together with the USA and which is an example for the attempt to find an alternative to the market economy system through socialism and communism. In the end Russia decided to return to a market economy. This transformation policy made Russia in the nineties into an example if not of an ethical market economy.

5.3 The Russian Transformation to an Unethical Market Economy

After Glasnost and Perestroika and after Yeltsin and part of the army held off the communist putsch, there was a historically unique chance for Russia at the end of the 1980s to make a fresh start economically and politically. Russia called in one of the most internationally renown economic scientists, such as the American Geoffrey Sachs, and thus representatives of the quantitative research trend of the period. The USSR was economically finished for good, not least of all because of the arms race with the USA, and discredited morally as a totalitarian system among a large portion the Russian population. Russia thus seemed to be a unique chance to apply economic theory in a practical setting and to create a flourishing landscape with the market system the theorists had dreamt up. Using a quantitative model Sachs found it reasonable to apply the elementary point of departure to Russia, and thus the functional prerequisites of the model, namely private property, contractual freedom and free prices all introduced overnight as a so-called shock therapy. The Russian economy did not develop as the model had predicted however, but fell apart visibly with the raw material sector being the only exception. Per capital real income fell to a third of its previous value. Unemployment, which had not occurred directly in socialism, became a mass phenomenon, and those who were lucky enough to have a job were often not paid. Many of the proud middle class in the USSR, the intellectual elite such as researchers, teachers, engineers and doctors were poverty-stricken or emigrated, as did the employees of the state such as judges and police officers. The educational system, social system and internal security all collapsed, including basic medical care for the population, all of which were quite obviously a public good in the USSR. The UN Human Development Report placed Russia in the early 1990s among the developed nations with a high standard of living. The system

[15] See Schwarz, Gunter Christian/Holland, Björn (2002), p. 1672.

collapse after the shock therapy threw Russia back to the dark ages in a catastrophe of biblical proportions. The average life expectancy for the population dropped from 69.3 years in 1986 to 63.4 in 1994, being just 57.6 years for men. Illnesses that had been long forgotten, such as tuberculosis and cholera appeared again. Alcoholism and other diseases of addiction also spread. More than 2 million children were homeless, much more than during the Russian civil war and World War II. Another 2 million children did not attend school. Criminality increased dramatically, with politically and economically motivated murders a daily occurrence. 10–15% of the population clearly benefited from the reforms, but 60% were made poor. What happened? It had nothing to do with the expected adjustment process to the new market economy framework. Were these the promised benefits of a market economy? Were these the flourishing landscapes?

Surely not. Where then, was the mistake? There were two elementary mistakes. The first mistake was that the shock therapy destroyed the existing economic and social institutions and organizations without creating new ones. The reforms were purely quantitative, which means that the specific qualitative conditions in Russia were not taken into consideration. The second grave mistake was to conduct the privatization from a regime that was not democratic. The two mistakes together meant that assets were distributed according the law of the fittest. Power and influence in the political cadres and access to resources combined with unscrupulous brutality set up the new distribution. 40–45% of the capital used to acquire assets is thought to have been from criminal activities.[16] The public legal and security systems were overwhelmed, incapacitated or were corrupt or disorientated due to a lack of political guidelines. New democratic or market economy structures such as institutions and organizations were nonexistent. According to the Analytical Center of Russian Academy of Science, 55% of company capital and 80% of voting rights in the public companies were acquired by Russian and foreign criminals. 85% of public property was sold at a low nominal value. In the end the American consultant Geoffrey Sachs distanced himself from the Russian market reform. In his opinion the Russian leadership had exceeded the worst prejudices of Marxists about the capitalistic system by understanding their function or goal as achieving private enrichment at the cost of the general population. The criminal circles did not hesitate to engage in murder in order to remove adversaries and resistance. We must fear that in the meanwhile large portions of the Russian economy and politics are in their hands. The illegal economy was neither recorded by the state nor controlled by the official economy, and probably accounted for around 40% of GDP at that time. It was impossible for an independent, innovative middle class to develop in this environment. Performance was never established as a criterion for economic success. Within 7 years between $300 and 400 billion in private funds was transferred to foreign banks. With this background it is not a surprise that in 1997 only 8% of Russians said they were better off than before the economic reform. When asked what was responsible for the "new Russians" doing so well, 39% was speculation,

[16] See Yurlov, Felix N. (1999); Åslund, Anders (2007) and Weigl, Tobias (2008).

34% theft from state assets and 17% the use of criminal funds.[17] This is what one would call predatory capitalism, an anarchistic capitalism at its extreme.

Tests for the success of the market economy reforms thus came back with disastrous results. The market economy system and so-called neoliberalism have not only been discredited, but have a negative association and not just since the subprime crisis. As a result of the unethical und disastrous Russian transformation they have been equated with social injustice, mass poverty, exploitation, hunger and impoverishment. Russia's experiences with a market economy were not seen in isolation, but have been transferred to the discussion on globalization. The idea that the market, competition and liberalism are able to bring welfare to everyone was doubted. The representatives of liberalism have been dubbed market fundamentalists by their new critics.[18]

Of course it is easy to criticize something after the fact. On the other hand, we would always be repeating the same mistakes if we were not prepared to learn from them. One of the main reasons for the failure of market economy reforms is the lack of attention given to the initial cultural and social situations, in other words the qualitative factors. What was the qualitative situation? Firstly, a functional market economy was as nonexistent in Russia as was democracy. There was thus neither a middle class that had arisen out of the enlightenment and industrial revolution, nor was there practiced market economy and democratic behavior available as human capital, which would have come from knowledge of market economic functions and individual behavior optimally adapted to market economic conditions or social capital[19] such as the function and practice of common behavior among supply and demand on markets. This may sound banal, but is it not banal in any way. When one must present themselves to an employer in competition with others, the way one must strive to attract customers, what customers should expect from a seller, that one must compare and deal over prices and quality are not abilities one is born with. A moral code for delivery and payment must also be learned. Paying bills on time is in principle a difficult thing for any customer, but he must learn that if he does not pay on time he will have to pay additional fees or face a lawsuit. This is necessary in the market economy system, since the supplier would otherwise have liquidity costs or might even go bankrupt, leaving other creditors all the way down to the employees without compensation. All of these examples are human experiences, rules of behavior that must be learned through practice in the market economy. These games must be played over several rounds so that people can see how they must behave in the market economy. The invisible hand of Adam Smith must be practiced. Behavior in economic freedom must be learned as much as behavior within political freedom.

The same applies for the system of political freedom, democracy. Market economy and democracy presuppose the existence of active, self-confident and

[17] See Lapidus, Gail Warshofsky (1995), Åslund, Anders (2007), Marsh, Christopher (2005) and Yurlov, Felix N. (1999), p. 5.

[18] See Yurlov, Felix N., (1999), p. 5

[19] For the expressions individual capital and social capital see Sect. 6.4.

responsible citizens, and democracy also demands an active, selfless political participation. Those people driving the economy and citizens must be informed and know what they want and actively work towards achieving it based on that information. Even an optimal market economy and democratic system as institution and organization will not inspire the desired behaviors in people, at least not at the beginning. First people have to learn the rules of the game in order to follow them, and they will not immediately behave in such a way in the newly created organizations that they would carry out their assigned functions optimally. To fully develop the productive forces the human capital in a market economy is required beyond just the organizations and institutions. Democratic human capital is necessary for a functioning democracy. There was no human capital for the market economy in Russia, which is why the transformation to a market economy had to fail as shock therapy. The same applies to the transformation into a democracy.

Because Russia was lacking both political and economic frameworks as well as human capital, the old social structures have taken hold in a new guise, the same structures that formed people during the time of the Czars, and which only nominally changed power holders during Communism. A small group of beneficiaries surrounded a dominant leader who got rich ruthlessly at the cost of the Russian people. At least under Communism the people received basic provisions. This is still no longer provided and the difference in wealth gets constantly larger. If this continues a new socialist revolution may result. Neither is the social situation endurable for the population, nor the distribution of assets acceptable, since it is based on immoral behavior instead of performance. The only chance for the new upper class, the so-called "new Russians" would be to create a new social market economy based on the existing property distribution and hope that the people forget the where the distribution originated. A functional tax system without a shadow economy, with which public goods such as education could be socially redistributed and financed would be a basic prerequisite.

To bring it all together we want to look for the lessons to be learned from the greatest national economic experiment of all time. A much-discussed and fundamental question of transformation theory is whether shock therapy or gradualism is preferable. The question can now be answered. A shock therapy, the short-term changes to all institutions and organizations from planned to market economy, or Socialism to Capitalism, can only work in exceptional cases such as after German reunification where an economically and politically stable country economically controls and socially cushions the change of a smaller country. In all other cases only gradualism is an option, as seen in the context of Russia's example. In fact Russia's experiences may well have moved China to decide in favor of a gradual release or changeover in its economy and ownership structures. Russia would have been better off importing human capital, in particular executives on a large scale from a country in considered suitable, as Peter the Great did in his reforms. This human capital, appointed to the most important political and economic functions, would have provided a gradual but constant dissemination and implementation of the necessary knowledge behind market economies and democratic systems.

If Geoffrey Sachs had predicted this development he would have given a different consultation, or perhaps none at all. Admittedly a consultant cannot be held responsible for a development over which he has no influence. Be he is responsible for the advice he has given. The project to transform Russia will always be connected to his name. A consultant always has the option of distancing himself from the project if his advice is not followed, but this only applies if the action is not taken at the important crossroads. The quantitative American line of research was simply overwhelmed due to its simplicity and was not qualified for a consultation on a practical economic and political order.

Geoffrey Sachs is a phenomenon who represents the current state of national economic science. He was and is one of it's largest figureheads. At 30 he was already a Professor at Harvard and meanwhile receives a salary from three departments at Columbia University in New York. Having been brought up and educated in a mathematical form of thought, it was easy for him to reach clear statements and recommendations. The models have another advantage in that they can be applied to any countries. Mathematics and econometric models are universally applicable and transferable. A model has variables, which can take on the respective quantitative country values. This is how Sachs managed to advise at least 75 countries. Did he know any of them? In Russia he later said that the corruption "was surprising" for him and that he had underestimated how much Russia was hindered by the lack of a functioning citizenry. Today he expresses doubt about the dominant economy, the standard education "has little use" and hardly any connection to the public.[20]

Admittedly the economic performance has improved in Russia. From 1999 to 2005 Russia's economy experienced an average rate of 5.5% real growth and the per capita income more than doubled from 2001 to 2005 to around $5250. Be that as it may, it could have been quite a different story. This economic growth is mostly due to the significant increase of raw material prices. The raw material price index CRB increased by around 81.6% from 2001 to 2005 and the price of oil by around 90%. Distortions caused by ruble to dollar conversions mean that we can only make approximations for the share raw material price developments had in Russia's economic upswing. For example, the oil price increased by 40% in 2005, but real oil production only by 2.2%. The CRB increased by around 23% in 2005, and Russia's exports in dollars increased by around 33% to approx. $241 billion, whereby raw materials comprised 67% of this, or around $161 billion. The exports minus imports were $36.8 billion, which increased GDP by around 4.8% to $766 billion. If we also consider the multiplier effects for the Russian domestic demand due to increased income from the higher raw material prices, we may conclude that the Russian growth is at least mostly due to the raw material price increases.

What is more, the majority of the population has barely profited from the positive development. We should wish for Russia that it finds a way to use the billions earned from raw materials for social security and education for the general population,

[20] See Heuser, Uwe Jean: Die Wandlung des Jeffrey Sachs, in: Die Zeit, no. 38, 2003.

which would provide a step towards long-term stabilization of a modern national economy.[21]

Conclusion
The subprime crisis has shown that a market system without rules and controls can not function. Although capitalism or better to say the market economy is responsible for many crises, it remains with its growth and individual freedom the best of all possible economic systems. Crucial is much more that rules and controls exist to prevent damaging individual behavior. The regulatory concept of ordoliberalism has prevailed against the laissez-faire liberalism. Additionally the society has to implement moral responsibility in order to get a functioning market system.

5.4 How Does the Market Economy System Work?

The market economy is described by many authors as being driven by common sense, using morality, social values and even solidarity. Starbatty contradicts Dietzfelbinger that morality and market economy have different rationalities, that is, the market can be immoral, but he believes that these are two ethical designs. Molitor sees the market economy as a moral institution, because it has the prosperity of all as its goal and it achieves best results. Here, he compares the pure market economy with the central administration economy. For him the higher productivity and the higher degree of freedom for the individual are an ethical advantage of the market economy. He sees the central social ethical justification in its orientation to the wishes of the consumers, as the prosperity of all. The market economy is considered to be ethically superior to alternatives such as a planned economy (central administration).[22] In principle, the Catholic Church is in favor of this assessment:

> At the national level of the individual nations as well as those of international relations, the free market appears to be the most effective instrument for the creation of resources and for the best satisfaction of needs.[23]

However, the Catholic Church does not see the market economy as sufficient to satisfy all human needs. For a Christian ethic, the basic statement of the pastoral autonomy of the Second Vatican Council is that man is the author, the center and the goal of all economics. This essentially corresponds to Kant's rules for reasoning.

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[21] For details about the Russian transformation see Weigl, Tobias (2008); Åslund, Anders (2007); Lapidus, Gail Warshofsky (1995); Grabrisch, Hubert/Holscher, Jens (2007); Javlinskij, Grigorij A. (1994), Der Spiegel, no. 39, p. 82 and Yurlov, Felix N., (1999), p. 7.

[22] See Molitor, Bruno (1989), p. 71ff.

[23] See Max, Reinhard/Wulsdorf, Helge (2002), p. 290.

5.4.1 The Picture of the Perfect Market in the Welfare Economy

The allocation model for the happiness of the greatest number as demanded of the utilitarianism market and competition is shown here.[24]

The resources of this world are limited and we humans have unlimited needs. Even if we are no longer concerned about survival, we still find new needs. We catch ourselves in the fact that if we have a product we have long desired, we finally have to think about what we want to have. In this sense, people are not actually made for happiness. On the other hand, this has the advantage that we never rest in our pursuit to improve our existence, which drives technological development.

The economic activity of man is necessary. The individual strives to produce enough goods for his survival and a good life. As a society, we must try to produce as many high-quality goods as possible from scarce resources. To maximize welfare, we must strive to produce products that maximize benefits to society. Our goal is the so-called allocative efficiency, whereby we use resources in the form that they bring the greatest benefit to society. Thus the term "economic" also indicates optimal use of resources. We define economically or efficiently as a method of reaching a given goal with the minimum effort for maximum return. In terms of resources, we maximize output to maximize the value of society. This so-called productive efficiency is the human goal independent of state form and era. Science is the result of people striving to produce the maximum quantity of goods for their own needs satisfaction with limited resources.

Our goal is to increase the benefits of all people to the extent that they cannot be increased without benefits to other people being reduced. We are therefore aiming at the so-called Pareto efficiency. We do not go beyond this consideration as economists. Increasing the usefulness of people at the expense of others is a social decision and not an economic one based on voluntariness.

In the market economy, welfare is achieved through voluntary exchange. People exchange their goods or services through markets, until no one can increase their utility without reducing the utility of another. In this way, Pareto efficiency is achieved. It is exchanged until the pareto-efficient state has been reached. This depends on the initial distribution of income and wealth, however. The more income or wealth a person has, the more goods they can acquire. If you buy a good for money, the benefit from this good must be higher than the alternative benefit from the consumption of another good (opportunity benefit).

Fraud is reduced in terms of the welfare system, because the benefit expected of the deceived exchange partner are not achieved after the exchange, and thus Pareto efficiency is not achieved. Moral behavior, on the other hand, would guarantee Pareto efficiency (Fig. 5.1).

In Fig. 5.2, A and B have different combinations of goods and therefore they can also be found on indifference or iso-utility curves that are different from the origin.

[24] See Fritsch, Michael/Ewers, Hans-Jürgen/Wein, Thomas (2011), pp. 30.

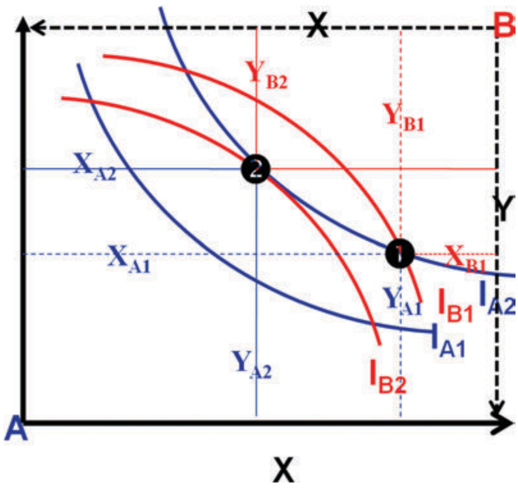


Fig. 5.1 Exchange optimum in the Edgeworth box

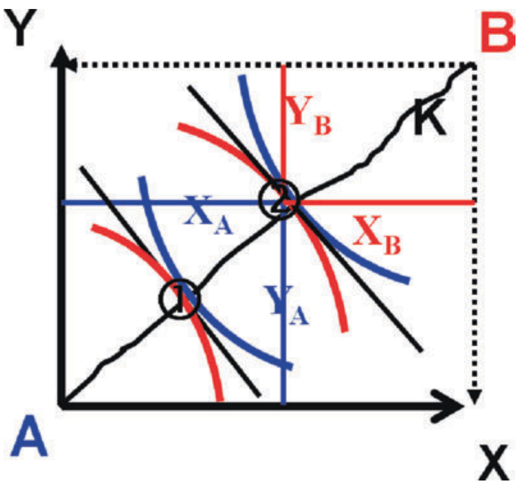
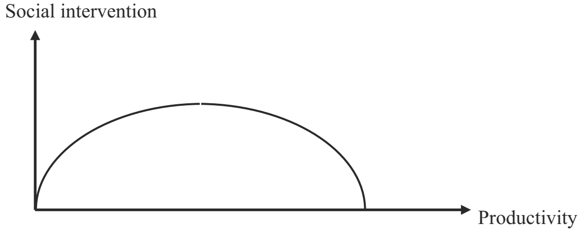


Fig. 5.2 Paretoefficient optima

❶ The utility of B can be increased with the same benefit to A, if A of good X is B, and B gets more Y. It comes to an exchange. In ❷ there is a pareto-efficient state, since the utility of A cannot be increased without decreasing that of B and vice versa. There is therefore a voluntary exchange: both have advantages (free lunch) until the pareto-efficient state is reached. Here the indifference curves of A and B are affected. The utility of A can not be increased without the benefit of B being reduced. This corresponds to an efficient exchange: both have exchanged goods for as long as both can no longer gain an advantage through a swap. The tangent at the point of intersection then has the substitution dY/dX as the slope the marginal rate of the exchange.

Fig. 5.3 Social intervention and productivity



However, this does not say anything about the distribution of benefits between A and B. From Pareto combination 1, B has a relatively higher benefit than for A and 2 is better for A than for 1, and vice versa for B (see Fig. 5.3).

Fraud deceives by promising a benefit to the other party in a voluntary exchange, which turns out to be non-existent afterwards. Thus the pareto-efficient optimum cannot be achieved.

The ethical result of the market economy can be attributed to competition functions.[25] The market provides the basis for the elementary competition functions with the price signals and the market mechanism. Prices indicate scarcity, costs, profit potentials and benefits (opportunity utilization). Without market competition, however, the market does not provide any allocation-efficient results.

5.4.2 Functions of Competition

As the example of Russia shows, the twentieth century was the century of competition between systems. Different economic systems were attempted. The market economy was able to establish itself as the basic principle of order. Socialism seemed to be the answer to many ethical problems created by the industrial revolution at first. Here we should mention the pauperization of the working class or the lower classes that were poorly educated or impoverished. Market and morality were considered opposites. Socialism considered the basis of the evil to be distribution of wealth via the central function of capital in the market economy as well as market mechanisms felt to be unfair and held responsible for the inequity of needs met. By removing private property and with the central coordination of production plans in the planned economy, a method was devised to better satisfy the needs of the society. Socialism, or Communism, was unable to develop the productive forces. The gulf in the standard of living between the capitalistic and socialist countries grew until it caused the socialist system to collapse. What remains however, are several questions about the market economy system that have gone unanswered. We have examined company crises and the errors in company organization. A lack of moral values or a code of ethics was determined to be a central cause for the crises as much as the one-sided focus on figures or quantitative facts. We have also analyzed Russia

[25] Zu den Wettbewerbsfunktionen See Conrad, Christian A. (2005), pp. 23.

as an example for an unethical market economy and an example of quantitative economic consultation. What comprises the system as a whole? What rules apply in the so-called market economy? What does market economy have to do with morality? Or, to ask it a different way, do market forces encourage or hinder moral and ethical behavior? We examine these questions in the following sections.

Because of its various forms, there is no generally accepted definition of "competition."[26] The core of the market economy competition could be seen as at least two market participants who compete with each other on the supply side and the demand side. In a market economy the decentralized decisions are made by individuals and coordinated via the market. Each participant is responsible for their own economic plans and decisions, and is then rewarded or punished by the market. The strength of the market economy is that all the productive forces of individual people are stimulated and coordinated. The limit is only human potential and their creativity or inventiveness and their level of education. The basic prerequisite for the development of market economic forces is competition with transparency in what is offered on the markets. Private property and the improved economic situation it brings for the individual is the main incentive of the market economy. Markets and competition fulfill various functions together.

There is no universally accepted definition of competition because of the many forms it can take.[27] The basic character of competition in a market economy can be understood as the contention between at least two participants on the supply side and those on the demand side. Competition forces the companies to be adjust their supply to correspond to the wishes and needs of their consumers (*steering function*). In a national economic system the desire to maximize profit produces the dynamic in which the raw materials with the best value are used in production. As we have already seen, striving to maximize profit guarantees that the raw materials to offer the best quality for the lowest price are the ones used (*1st allocation function*). In addition, the most cost effective company has the highest demand and can attract more production because it has the most room to maneuver with its prices (*2nd allocation function*).[28]

Companies achieve optimal success when their costs equal the profits from an additional unit of production. When he has enough influence, in other words a lack of competition such as in a monopoly, the entrepreneur will set a price far above his costs. Competition forces prices down towards the production costs through dispersed market power. Lower prices are then charged for a higher quality product, both for finished products and raw materials. This increases consumer profit in the case of finished products and the international competitiveness of a country for raw materials, thus indirectly also affecting employment. Competition guarantees that over the longer term only companies using their resources efficiently (*productive*

[26] See Herdzina, Klaus (1984), p. 9.

[27] See Herdzina, Klaus (1999), p. 9.

[28] According to empirical estimations, in a polypoly – as opposed to a monopoly – the static welfare gains in one period alone constitute 10% of the GDP. This is assuming there are no secondary effects. See Scherer, F. M. (1996), p. 11.

efficiency) can stay on the market (*sanctioning function*). Trying to keep a step ahead of one's competitors prevents resources from being wasted and encourages relative prices to be corrected for production factors.

Competition leads to a fair market remuneration and thus provides motivation for good performance, which is in turn the basic requirement for productivity (*distribution function*). The remuneration from the market is often felt to be unfair.[29] Competition provides a lot of leeway for those participating in the market to develop their potential. Companies can thus take responsibility for their reaction to decision-making parameters, workers can change their employment, and consumers have the freedom to choose between many different offers (*freedom function*).[30] Many suppliers competing for the same consumers automatically limit their economic power, making market-controlling positions impossible (*control function*).

The competition we have described thus far is in reference to a point in time and is thus referred to as static competition. The dynamic character of competition is especially important for the growth process of an economy, however.[31] Successful companies must also continually try to gain a competitive advantage over their competitors by offering new products and new production techniques (*adaptation function*). Friedrich August von Hayek portrayed dynamic competition as process of search and discovery, through which things are discovered that would otherwise have remained unknown or at least not made use of. Competition is evolutionary for Hayek,[32] which applies to both product and process innovation. Innovation can be understood in this context as the economic application of a discovery, in other words invention. In the expectation of above-average rewards from the market an entrepreneur is always searching for cost-effective methods of production and new products for which there is a potential market demand. The entrepreneur conducts risk assessment at their own costs or analyses external research results. The market decides the success of an innovation and thus in the end the consumer or producer that further refines a product has the last say (*innovation function*). Should an entrepreneur decide not to bother with innovation and invention, they will be pushed off the market by their competitors (see adaptation and sanction function). It is clear that the functions of competition and adaptation are closely connected with each other. If companies fail to adapt their products to the demand structures on the market and international division of labor, they will also be sanctioned by the market.

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[29] This is how the scarcity of a good leads to market position gains, or profit without service. Ordinarily those unable to offer good performance would not be rewarded by the market and would therefore starve. This leads to the question of fairness and the acceptance of a neo-liberal economic system. Fairness is a moral and ethical question, thus at once subjective and not a subject for an economic science text, but rather a philosophical or theological framework. The question of acceptance is decisive for the feasibility of any system however, and may therefore not be neglected. This was clear in the hefty demonstrations against the expansion of free trade in Seattle 1999.

[30] See Berg, Hartmut (1999), p. 233. The Freiburger School sees the equivalent of democracy in individualistically oriented competition, and thus the prevention of a dictator.

[31] See Heuß, Ernst (1968), pp. 29 for the importance of competition for the growth process.

[32] See Hayek, Friedrich August von (1969), p. 249 and Starbatty, Joachim (1987), p. 164.

According to Joseph Schumpeter,[33] competition is a process of innovation and subsequent imitation (*imitation function*). The successful innovation on the part of the pioneering company proves a competitive advantage over other companies on the market who have maintained their old production structures. Above-average profits are won from this advantage, which in turn makes other companies want to copy the invention, or even forces them to do so if they do not want to be pushed off the market. This is how the new, resource saving methods of production come about, and thus brings about widespread technological progress and production growth.[34] Innovation and sanction functions thus support each other in dynamic competition.

From the perspective of the individual companies it would be positive to restrict competition. For one thing, when a company profits from an increase in its market power, such as those from a monopoly, it reaps the benefits without having to work for it. Competition is also a nuisance, in that it forces companies to constantly better their performance. If they do not adapt to the market and innovate they must face losses or may even have to withdraw from the market altogether.[35] The state must protect competition in order to make sure that companies cannot elude the competition functions. Are these functions applicable at the international level, though?

The competition forces companies to continually try to gain competitive advantage through new products or production processes, or at the very least to catch up with the competitors' competitive advantages. On the one hand, this reduces the use of resources and, on the other hand, adapts to changes in the relative prices of production factors,

This principle must be the same internationally,[36] though there are country-specific absolute and comparative cost advantages (Ricardo's Theory of Comparative Cost Advantage). According to Ricardo even a unilateral liberalization of foreign trade would give the importing country an advantage. Scarce production factors in individual countries would balance out internationally, which would in turn lead to higher total productivity.[37]

The largest part of world trade takes place inter-sectorally, which means within a branch and between the western industrial nations that have similar cost and demand structures such as capital and labor provisions. How does foreign trade come about even when there are identical cost and demand structures? This can be explained by the specialization of the producers to various demands. Foreign trade as cross-border competition forces the suppliers to orient themselves to the international

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[33] See Schumpeter, Joseph Alois (1911).

[34] For an explanation of "Schumpeterschen Unternehmers" See Dürr, Ernst (1987), pp. 245 and Vickers, John (1994), pp. 17.

[35] See Drude, Michael (1991), p. 7.

[36] Empirical proof of the positive effects from import competition on productivity can be found in MacDonald, Porter, Baily, and Gernsbach as well as in the studies from the EU-Commission on gains in welfare within the European domestic market. See Baily, Martin/Gernsbach, Hans (1995); Commission of the European Communities (1988); MacDonald, James M. (1994); Porter, Michael (1990) and Scherer, F. M. (1996).

[37] See Conrad, Christian A. (2003).

demands and or to qualify themselves for a market niche. The broad pallet of products to result from this process is also a gain in welfare. Gains are also possible digressively, in other words with a reduced amount of production within the framework of international specialization. With the increased demand corresponding to the world market, production amounts increase and thus unit costs decrease.[38]

In principle then, globalization as national markets growing closer together into one national market leads to an overall higher level of welfare. How the benefits are distributed is another question. This is mostly because with changes in international production the jobs are shifted and cause short-term structural unemployment.

Unfortunately the advantages and functions of the market and competition are not public goods, which is surely the main source of the rejection and hate directed at the market, and at the international market in particular. The willingness of states to explain and educate is desperately needed.

Can the market process really regulate everything based on human egotism? Does the market really need morality? Is it really true that the more profit companies make, the more immorally they behave? Do the laws of the market even allow companies to act morally?

5.4.3 Moral Goals and Market Economy

The market can not solve all human problems. The solution that the market has developed is that each person pays for the performance they want. The problem creates a demand that creates its own supply. The market only knows the principle "due ut des" as the principle for trade. This mechanism often functions, but not always. The reach of market forces is limited. Superordinate and subordinate relationships have always exited. In every group of apes or humans there is a social order. There are also different mental and physical capabilities and different access to resources, especially in humans, which determines power, dependencies and hierarchies. For example, the resource distribution in Latin America and many developing countries cripples their economic development. Whoever was able to grab something now owns it. Lands and assets have often been inherited within the same family for centuries. Like noble titles, the children of these families have inherited the fortunes of these families without any effort of their own. They have the capital for worthwhile investments, however. Distribution of assets and welfare are therefore set, just like the hierarchical relationships. Anyone without land must work for the others as a dependent employee. In order to change anything in the order and the distribution of wealth, one must have power and even use violence. If this is the case, power through strength or access to resources is a central factor in the social order, which is much stronger than the market mechanism. The given factors of power make the question of whether spontaneous market mechanisms and their ability to fix themselves are sufficient, or whether the state must provide an additional framework

[38] See *Conrad, Christian, A*. (Conrad 2005) and Bender, Dieter (1992), pp. 419–448.

with its order and even directly intervene in the market mechanism obsolete. The voluntary, mutual, advantageous exchange of goods is more of the exception. The market mechanism can only ever control a small part of the societal exchange process, so it is more of a question really of how much and which system of order, and when the market mechanism is appropriate and when it is not. This question is settled to a large degree by the social framework conditions, as will make clear with the example of Russia.

A lack of property means dissatisfaction, since threatened survival means having to enter into dependent employment, or the rental of one's own time and labor. The distribution of income in a market economy is only oriented towards performance to a certain extent, since the initial distribution of wealth is differently inherited. However a market economy system with the correct conditions provides for a distribution of income based on performance, and thus leads to a more balanced equity distribution with time.

Business ethics places people above the economy, and assumes that the economy should serve the people. There are other perspectives on this, whereby economic success justifies the means. Economics would then be placed above morality. According to Calvinism, economic success is s sign of God's benediction. Economic success is thus not only morally legitimized, but those with success have been chosen by God. There can hardly be a greater incentive to strive to earn more. Hard work and asceticism are then the fundamental characteristics of a successful Calvinistic enterprising personality.[39]

This idea contradicts the original Christian belief of justified wealth. This has been expressed in sayings such as "it is easier for a camel to go through the eye of a needle, than for a rich man to enter the kingdom of heaven."[40] Theologians from the middle ages demanded that no Christian work as a salesman, since breaches in loyalty, honor and virtue would result from exchange with the promise of profit in the spirit of greed.[41] Market prices were felt to be unfair (Thomas von Aquinas (1224/25–1274 A.D.) or generally the income distribution of the market, because it was not based only on performance and it completely neglected human needs. The Christian economy was to be a responsible and thus free proposition and establishment of as many individuals as possible for the good of everyone.[42] Adam Smith (1723–1790), shared this view with his "invisible hand" of the market that led to the benefit of everyone.

The moral expectations confronting economy is ancient. Aristotle (384–322 b.c.) had already differentiated between the art of naturally acquiring or procuring and the art of enrichment (chrematistic) which he condemned because it did not naturally occur but was rooted in the weakness of mankind. Striving after money

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[39] Max Weber had already recognized the source of the positive economic developments in Switzerland, the Netherlands, England and parts of Germany as being from the Protestant or Calvinist influence. See Ulrich, P. (1998), Sp. 1168f and Noll, Bernd (2002), p.166.

[40] See Schwarze, Gunter (2007).

[41] See Wilkening, Hans-Rüdiger (2004), p. 61.

[42] See Beutter, Friedrich (1989), 56–75.

becomes an end in and of itself, which distances man from his natural purpose, namely satisfying the elementary needs for a good life. Aristotle places virtue above economics because man can only achieve happiness by exercising his virtues. The perfect virtue for Aristotle is justice, which serves as a norm for the economy. He does not understand distributional justice as the equity of needs as did Socialism, but rather equal for the equal and unequal for the unequal. According to this principle from Aristotle there must also be a redistributive justice, which balances out unjust distribution results such as those from fraud.[43]

Moral Property

The human factor as individuals is the central actor in the market economy. In a market economy the market mechanism coordinates the plans of individuals through the market price which matches supply and demand. The basic prerequisite for a total economy to develop optimally is that competition dominates the markets. Private property and its augmentation are the main incentive for individual economic activity. More is required than just the free interaction of supply and demand for such a complex system to function, however. For example, to transform a socialist planned economy into a market economy, allowing free price-setting and creating private property is not sufficient. What good is property if it is not protected or acquiring it is not regulated? The market economy conditions are thus much more extensive than those according to the theory of order from Walter Eucken, and include a functional legal system, among other things. Insufficient attention was given to the necessary conditions in the consultation for the countries leaving Socialism or Communism, as we saw in the example of Russia. With the currently dominant mathematical and quantitative perspective being taught, the market is assumed to function ideally. The human factor is systematically ignored because it cannot be put into deterministic models due to its often irrational nature. People are equal in their rights, but not in their behavior. Thus the market economy could not be successfully established in Russia. People are formed and socialized by their environment from birth. Market economy behavior must be practiced. The market economy demands a different behavior from individuals than planned economies do, such as individual responsibility. An abrupt changeover from planned to market economy is like suddenly demanding a spoiled housecat go catch its own dinner. It is not possible to just switch from a feudal agrarian system or a tribal or clan system to a market economy with individuals that can hardly be controlled without going through an adjustment process.

For the mendicant from the Dominican order, Thomas von Aquinas, all goods are God-given. They are only entrusted to people for their earthly use. Like Aristotle he rejects ownership as an end in itself. Property should serve the good of humankind. He rejects common property as well, since no one would feel responsible for it. According to the idea that "property binds," those who have possessions should give

[43] See Schefold, Bertram (1989), p. 19–55.

some to those in need. Property is generally to be used with consideration for others.[44]

Even without using God as an argument the question of justifying the use of property arises. Property can serve a single individual or the community. If an economy is to serve the good of the community, property may only be obtained through participation in the economic process. Performance on the market, thus evaluated by other people, contributes the most to the general good via the rules of the market and competition. Deceit or theft is obtaining services or property from others without reciprocation, which is usually only possible through devious means or the use of force.

Moral values are expressed e.g. through "fair competition". This includes the moral demand that the fruit of the market, income, should only be received by those who contribute, in other words those who outdo their competition through an exchange of effort on the market and open competition and not through advantages. Whenever assets are not earned through effort, the community will not accept an unequal distribution. In extreme cases assets are immoral, when they are obtained through theft and fraud. Societal approval as a motivation to perform well disappears in such cases. The motivating model of the American dishwasher who worked his way up no longer has any effect, since effort does not pay off. Property is therefore above all a motivation to perform well. Adam Smith was the one to recognize its importance the most comprehensively. On the other hand, as Smith considers the cause, or driving force, behind the development process to be the constant striving of people to improve their material situation, those who are "satisfied" and those who are hungry but cannot amass assets are hardly motivated to make an effort. The development of productive forces thus requires equitable rewards for performance as the distribution principle for income and assets, which the market evaluates as the location of all material needs of the community.

It is of no importance for the market and the general good whether the performance comes from the necessity to meet one's basic needs or from limitless greed, glamour and power. The market is only interested in the performance, not the motivation. The individuals bear the consequences, not the community. Each person has just one life and must decide how to invest his energy during his lifetime and for what ends, insofar as conditions allow. However, for the community it can be a problem if too many individuals make egotistical economic gain their life goal, seeing ruthless property maximization as an end in and of itself.

Independent of subjective assessments, the economy may not be its own end, which applies for all instruments used by people to survive since they have existed. The economy must serve people, not the other way around. This statement is always universally valid, including this era of globalization.

What role should money play in a market economy as property? Money functions as an exchange and value retention device, as well as a unit of calculation with all of the price signal and competition functions connected with it. Money is of central importance in a market economy. Because of its value retention function,

[44] See Beutter, Friedrich (1989), 56–75.

money represents purchasing power and thus power. The market mechanism consciously relies upon egotism and the human striving to enrich themselves, and money is the means to do so. Money makes it possible for the market economy incentives and thus Smith's invisible hand to function fully. Money should always be a means to an end however, not as a dominant societal goal in and of itself that replaces other important goals including social morality. For example, if we assume that the end justifies the means, it would mean that every damaging action for other people or the community would be justified. The top manager who sold his stock to others even though he knew his company would do poorly would be a societal role model just because he got rich. Social morality is thus an important corrective in a market economy. If a market economy works for the advantage of the community, the community must condemn immoral, damaging behavior through legal punishments or social exclusion.

For Kant, the market has its limits where dignity is at stake and therefore there can be no price:

> In the realm of purposes, everything has either a price, or a dignity. What has a price, in its place can be put something else as equivalent; which, on the other hand, is superior to all price, and therefore does not allow any equivalent, that has a dignity.[45]

For the market and for the general good, however, it is irrelevant whether the service meets a necessity for the satisfaction of basic needs or arises from boundless greed, courage and power. Only the performance on the market counts, not the motivation. Individuals must bear the consequences in this case, not the community. Everyone has only one life and, as far as possible he has to consider precisely towards what goals he uses his life and energy. For society, however, it can become a problem if not only a few individuals, but many see their life purpose exclusively in the selfish economy, that is, in the unqualified property maximization as self-purpose.

Moral values can be found, for example, in the term "fair performance competition". This implies that the moral demand that only those who perform well receive the fruits of the market, the income, that they not disadvantage competitors in the market and that they succeed in fair competition through their own efforts. If assets are not earned through performance, there is also a lack of public acceptance for unequal distribution. Or, in the extreme case, wealth is even immoral if it is acquired by robbery and fraud. Performance motivation, social recognition, then ceases to be effective. The motivating role of the American dishwasher, who has worked hard, is missing. Performance is not worth it. If an immoral success without performance becomes the rule, performance is no longer worthwhile and the productivity of the market system decreases. The same applies if the property acquired through performance is regularly robbed or taxed too high.

Property is therefore primarily a means of motivation. This was recognized as early as Aristotle.[46] Adam Smith recognized its importance most extensively.

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[45] See Kant, Immanuel (1785), p. 434.

[46] See Aristoteles (1991), p. 17 or 1263a.

Conversely, when Smith sees the cause or driving force that determines the process of development in the constant striving of man to improve his material situation, people who are "full" and people who are hungry, but cannot acquire property, are little motivated to perform. The unfolding of productive forces therefore presupposes a fairness of the distribution of the income and wealth. It has been shown in Chap. 3 that people demand a fair distribution of the collective gains in order to participate in group performance.

Economically, it is necessary to distinguish between the justice of exchange, the justice of performance and the justice of needs.

Justice of Exchange is often assumed in market transactions to be voluntary. It is assumed that both parties agree only if the exchanged benefits are beneficial for both (free lunch). If both improve their position in the exchange, the welfare of all is improved (Pareto efficiency or overall economic optimum, see Sect. 5.4.1). However, consideration must be given to whether there were dependencies or power positions. Rawls speaks of procedural justice in this context. Economic procedures should lead to fair distribution results. For example, competition on the markets as a procedure ensures a fair result only if it is not limited by monopolies, cartel agreements or the like, or eliminated by corruption.[47] The competition thus legitimates the market economy as an ethical process. In order to ensure fair competition, there are competition authorities and laws regulating how unfair competition law is regulated, such as misleading buyers about product properties, fraud, and exploiting inexperience, etc..

For example, if the employee is dependent on the employer to ensure his/her survival, it can not be assumed that the "voluntarily" accepted wage is just because it corresponds to the employee's performance. In this context, the unions are important in order to establish a fair method. They have the task of bundling the interests of employees into a negotiating position, thus balancing the unequal distribution of the economic power of many "small" workers (suppliers) against a large monopolist labor market (bilateral monopoly).

The justice of needs is a contrast to the justice of exchange, since a claim is regarded as just if it is based not on a performance but on a need. For example, Pope Leo XIII said in the social encyclica "Rerum novarum" that a worker must be able to earn with his wages, his livelihood.[48] But we do not find any need for justice in the market economy.

In the case of the justice as regards performance, remuneration is based on the performance as assessed on the market. Productivity is the basis for this assessment. The value added is generated by the employee or the company. This does not depend on the effort made, but on the result and the evaluation by the market, which is measured as demand.

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[47] See Rawls, John (1999), pp. 73 and 240.

[48] See Papst Leo XIII. (1891), No. 34; Höffe, Ottfried (1997), p. 93; Schmidt, Heinrich (1982), p. 225 and Göbel, Elisabeth (2010), pp. 152.

Ultimately justice is considered very subjective. For example, equal pay for equal work was demanded by the East German workers after reunification. Objectively, however, due to the old economic system the East German workers were less productive than the West German workers. The well-known principle of equality by Aristotle is therefore: “The same is to be treated equally and unequal unequally.”

Despite evaluations being subjective, one thing must be said about the economy that applies to all the instruments that have been used by man since his existence to secure his survival. The economy is not self-serving, it has to serve man and not vice versa. This statement is always and universally applicable.

5.4.4 Social Market Economy

The market and competition offer great advantages, expressed in the market functions already described. Other social or humanitarian goals such as a margin of subsistence or the compensation of market power between employer and employee cannot be explained through the market and competition, however. Other institutions and organizations are necessary for such goals, and are incorporated into the economic order. The market only considers interests important if they have market power. An employee who cannot find a demand for his skills on the labor market because of an overabundance of competitors with his job qualifications will not receive compensation from the market. On the other hand, the employer can afford to treat the employees he already has poorly, since they are so easily replaceable, a behavior which would otherwise be punished via the market.

Market sanctions are moody and sometimes unfair. The market rewards luck, such as those who already have a scarce resource with market condition profits, or a scarcity benefit. Real estate speculators for example, count on the real estate supply being limited with an increasing demand. Hard work itself is not a value for the market. Hard work is rewarded only if labor leads to something others are willing to pay for. In other words, without a product for which there is a demand, there is no reward from the market, which can mean starvation. There is no such thing as compensation according to need in the market system. The criticism from Karl Marx regarding the market economy system is thus justified. Charity and sympathy are foreign concepts to the market. Market and competition are instruments to achieve only some of humanity’s goals, and they must be supplemented by other social regulations. This is where the social market economy comes in. It differentiates between primary and secondary income distribution, which closes the gap between economic and social goals. Since there is no intervention in the primary income distribution of the market, such as price or competition-distorting subsidies, the market and competition continue to function. The subsequent control of income created allows a certain amount of social goals to be realized, such as securing a margin of subsistence. Social market economy does not mean interfering in the market mechanisms for social purposes, as it is often misunderstood. Social menas societal, not socialist. Applied correctly, the concept of a social market economy is preferable to all other forms.

This statement may cause objection at first, but it will be understandable when we remember all of the things that the market cannot provide. We already identified securing a margin of subsistence. What would the advantages of this be? The first may be the avoidance of social unrest. A person who fears for their existence may be prepared to do anything including criminal activities. The willingness of market participants to take risks may well be much higher if they know that should their investment or founding of a company fail, their physical survival will still be secure. This would encourage enterprising or innovative behavior. Securing a level of subsistence also guarantees human capital for the economic process. A policy of financed education through redistribution can be justified economically as an investment in human capital. The productivity of those who have been supported increases, thus increasing economic power and income through taxes for the country. A good basic education also strengthens democracy, since citizens no longer believe unbalanced, one-sided arguments so easily. On the other hand, support for primary and university education exclusively through private scholarships will not provide a broad system of human capital. Procuring external knowledge is an alternative for the national economy and for companies. The international competition between states and companies for resources is not just over capital, but also over human capital.

It would be a fallacy to think that the community, the state, could provide for all the responsibilities in caring for people and perhaps even raising children. It must intercede where there are no family members, but the idea that people only behave egotistically and hand over all duties and responsibilities to the state is contrary to human nature and is simply impracticable. Not even the Socialism that existed went so far.

How can we explain that in reality countries that call their form of economy a social market economy, e.g. Germany, are not necessarily superior in economic productivity to exclusively market economies such as the USA? Most countries have a mixed form. Even the arch-capitalistic USA often demonized by socialists is not a purely market economy, since it has social security, even if not very much. An active social education policy is not implemented, but they do use clever lures for human capital, in particular through the elite American universities. Germany refuses to take this path in the belief that an active educational policy is sufficient. Most European universities are no competition for American universities in the international human capital market due to the lower salaries.

Under a social market economy we understand the combination of free market with social compensation (**definition**). This is where the concept of the social market economy begins. It distinguishes between primary and secondary distribution of income, thus balancing between economic and social goals. Since the primary income distribution of the market is not influenced, for example through subsidies which distort prices or distort competition, the market and competition remain functional. The subsequent taxation of income generated can be influenced to a certain extent by social objectives, such as securing the subsistence minimum.

The term "social market economy" was introduced by Ludwig Erhard, who was the first Federal Minister of Economics of the Federal Republic of Germany from 1949 to 1963. The term was first mentioned by Erhard's comrade-in-arms Alfred Müller-Armack, who was head of the Economic Policy Department in the ministry of economic since 1952, in his book "Wirtschaftslenkung und Marktwirtschaft".[49]

Social market economy, therefore, does not mean to enter the market mechanism socially, as is often misunderstood. Social is not socialist but societal. Properly implemented, the concept of social market economy must be superior to all other economic contexts because it balances the disadvantages of market and competition through additional regulations.[50]

This statement is likely to produce a contradiction, but becomes understandable when one realizes what the market cannot afford. We have already mentioned the protection of the subsistence minimum. What is the benefit of this? We first think of the prevention of social unrest. A person who has to fear for his existence is willing to do anything in order to survive and will likely not shy even from criminal acts. However, the risk attitude of the market participants is also likely to be higher if they know that in the event of a failure of their investment or business start-up, at least their physical continuity is guaranteed. This should encourage entrepreneurial or innovative behavior. In addition, by simply safeguarding livelihoods the human capital for the economic process is preserved. An education policy financed by redistribution can also be justified economically as an investment in human capital. The productivity of the beneficiaries increases, and thus also the economic power and the tax revenue of the affected country. Good general education also strengthens democracy, because citizens are no longer so easily exposed to unbalanced one-sided arguments. An exclusive promotion of school and university education with private scholarships will not be able to guarantee a broad range of human capital. An alternative here is the acquisition of external knowledge for the national economy as well as for companies. The international competition of states and enterprises for resources includes not only capital, but also human capital.

The main structural building blocks of a social market economy are social, pension, unemployment and health insurance, a free educational system and a progressive tax system.[51] This results in ethical advantages, inasmuch as a benefit is generated for people. A secure existence and health care regardless of income, as well as equality of opportunity through free education, are important prerequisites for a good and meaningful human life according to Aristotle. However, there are

[49] See Müller-Armack, Alfred (1947), p. 88; Zweynert, Joachim (2008) and Bundesministerium für Wirtschaft und Technologie (2013).

[50] In a sense, Aristotle already foresaw the social market economy in which he wished to make use of the advantages of private property but also wanted to make private property available to the community: "On the other hand, an order of property which follows the custom and which is characterized by habitual behavior and the Order of proper laws is a great advantage: it should combine the advantage of both orders-by this I mean the advantage of common property and of private property."

Aristoteles (1991), pp. 17 or 1263a. (author's translation)

[51] See Bundesministerium für Wirtschaft und Technologie (2013).

also economic advantages. Social market economy pays off. The main economic advantages are:

1. Development of human capital through a government financed education system

   Educating the population increases productivity. Employees with better skills earn more. Due to technical progress the demands on the qualification of workers are increasing. A high human capital is once again the prerequisite for innovations, i.e. technical progress. And innovations increase the productivity, competitiveness and profits of the industry of a country. Well-paid jobs are created. This all leads to significantly higher tax revenues. Investment in the human capital of the population thus pays off in many ways.
2. Greater equality of opportunity and thus better economic use of human capital

   The education that a person receives should not depend on the income of his parents, but on his abilities. If education has to be paid for, there will always be people whose skills could not be developed because they could not afford the training.
3. Preservation of human capital by statutory health insurance

   It makes little sense to invest in human capital and then let it be destroyed by illness. Even well-trained workers can become unemployed. If they can no longer pay for their health care, the human capital is lost.
4. Social peace through a state guarantee of the subsistence minimum and a redistribution in the form of progressive taxation.

Anyone afraid for his existence is ready for violence. A market economy is more likely to be accepted as an economic form if the inequality of the distribution results is mitigated. Not least of all, the distribution results of the markets are not just based on performance and are sometimes perceived as unjust.

The principle of assistance for self-help applies. This principle of subsidiarity derives from Catholic social doctrine.[52] The social market economy also corresponds to Rawl's principle of justice. Everyone can be freed from their interests by moving into a primitive state, without social differences, in order to ensure procedural fairness when establishing social institutions. Out of a veil of ignorance the citizens do not know their fate and must fend for themselves in the worst case.[53] However, if they do not know whether they are born poor or rich or have health problems, they need social security and basic care. They would, therefore, opt for a social market economy with social redistribution as an insurance against the worst case scenario.

But how do we explain that in reality, countries that characterize their economic form as a social market economy, such as Germany, are not necessarily superior to the other almost exclusive market economies, such as the US, in the productivity of

[52] See Schulte, Bernd (2000) and http://www.uni-muenster.de/Geschichte/SWG-Online/sozialstaat/glossar_subsidiar.htm

[53] See Rawls, John (1979), p. 158ff and 341, and in the original Rawls, John (1971), p. 10ff, 12, 139 f.

the economy? Most countries are mixed forms. Even the US is not a pure market economy, but has a social security, albeit a small one. An active social education policy is not being pursued, but the skillful abolition of human capital, especially by American elite universities. Germany, for example, renounces this in the belief that an active education policy alone is sufficient. However, due to lower salaries for professors, most European universities are not able to compete with the US in the international competition for human capital. The term “socialized market economy” also applies to Germany as a “social market economy”. On the one hand, a large number of economic sectors were directly involved, with the result that competition and market functions were disrupted. On the other hand, taxation and social protection have been exaggerated to the point where the incentives have been adversely affected. This was at least partly corrected by the Agenda 2010 of the Federal Chancellor Schröder.

Higher productivity as all as social peace arists through the building blocks of the social market economy. In general, therefore, a correlation can be drawn with the Laffer curve[54]: the productivity of an economy initially increases sharply with an increase in the social intervention of the state, but the increase lessens and then decreases from a maximum with increasing rapidity. This is a semicircular-like functional relationship:

Conclusion

As the example of Russia shows, the twentieth century was, among other things, the century of system competition. Various economic systems were tried, but the market economy won the system competition. At first socialism seemed to offer an answer to the many ethical problems that arose during the industrial revolution. In this context, we should mention the impoverishment of the working class or the lower poorly trained and simply poor population strata. Market and morality were perceived here as a contrast. Socialism saw the ethical basis for the unjustly perceived prosperity distribution in the central function of capital in the market economy and in the market mechanism, which was blamed for the lack of justice in needs and distribution.

Summary

The market economy is considered to be ethically superior to alternatives such as a planned economy (central administration economy) because it achieves the moral goal of adequate prosperity with a higher degree of individual freedom. The competition functions lead to an ethical result in the sense of a justice for performance. The social market economy is the ethical expansion of the market economy. It combines the productivity advantages of the market economy with ethical aspects, which can increase the productivity of a pure market economy when properly applied. However, there is a risk that overriding social interventions can severely limit competition and lead to the same problems as in the central administration economy.

[54] The Laffer curve describes the relationship between tax rates and tax revenues.

Planned economy considered the abolition of private property and the central coordination of the production plans to be two tools to better meet the needs of society. But socialism, or even communism, could not unleash productive forces. The prosperity gap between the capitalist and socialist states became ever greater until the socialist systems collapsed. Nonetheless, the social market economy cannot eliminate all ethical weaknesses in the market economy. The greatest damage is caused by market failures, as we shall see in the next chapter.

Comprehension Questions

1. What are the advantages of the market economy as a system?
2. Name and explain the competition functions.
3. Is there a conflict between market and ethics?

5.5 Market Failure

Markets are by no means perfect, since they are created by people. Markets increase economic efficiency, but the idea that markets are always efficient is an unrealistic idea of theoreticians detached from reality. Of course not all information relevant for the market is known, or procuring it is too expensive or difficult. A large part of market failures and crises can be explained by human failure. People overshoot, there are speculation bubbles and pig cycles. If the market were efficient there would be no successful speculators. Most transactions are created out of stocks, since buyers and sellers estimate the future of the stocks differently. Absolutely efficient markets are impossible because the actors in the markets are humans. Humans are fallible. As we have seen in Chap. 3 they are emotional and imperfect, and do not always act efficiently or rationally. Even if humans strive to attain perfection, or occasionally claim to be perfect or have god-like control over nature, they are not. At the very most they are just slightly ahead of everyone else.

In the market, individuals make their decisions independently. No discourse takes place beforehand, taking into account the interests of all parties involved. For this reason, there is also a clash between individual benefits and social benefits in the markets, which will lead to market failure, as we shall see below.[55]

5.5.1 Market Failure Due to Non-exclusion

Public goods are goods in the national economy whose benefits for society (public utility) exceed the individual, because the utility is freely available and the market participants cannot be excluded from its use. For this reason, public goods are

[55] The unethical effects of so-called external effects on uninvolved third parties are not taken into account, however.

offered in small quantities or not at all through the market mechanism. The fact that the market fails here is widely accepted. Let's take clean air. Clean air can be produced not just for one person, but everyone in the same environment also profits from it. However, using the air does not make is scarce, so there need not be rivalry to use it. Examples of other public goods from which individuals cannot be excluded would be internal and external security. There is an acknowledged market failure in all of these goods. Since no one can be excluded from their use, many would not want to participate in the cost and hope others finance its procurement. In addition, there are high transaction costs and the impossibility of an individually agreed financing, which is why the state has to provide these goods to society through compulsory contributions (taxes).

There are also public goods in the private sector, where there is the problem of free riding. Whenever several people want to purchase an item where the usage cannot be made exclusive, there is an incentive not to participate in the cost and still use the item. Let's take the acquisition of a common television in a student hostel as an example. Moral behavior would preclude such parasitic behavior and every student would honestly admit that he wants to use the television and participate in the cost.

Social morality or better ethics as practiced moral behavior is itself a public good. Everyone benefits by cooperative, considerate, and courteous behavior. Social morality is a public good. The benefit is arbitrarily divisible, thus not competitive and no one can be excluded.

The methods described in Sect. 3.3. Individualism versus collectivism of public goods showed the importance of social sanctions (norms) and learning or socialization.

5.5.2 Market Failures Due to Asymmetrical Information

The model of the perfect market assumes complete market transparency. Market participants have all the information relevant to their decisions.

One speaks of asymmetric information when the parties have unequal knowledge about:

(A) the properties of the product to be exchanged (Hidden Characteristics)
(B) the behavior of the partner after conclusion of the contract (Hidden Actions) and/or
(C) the intentions of the partner in the Hidden Intentions.

The economic participants have different knowledge and one party can exploit this unethically to the detriment of the less informed. This party then has less value than expected, which leads to a non-pareto-efficient situation.

(A) Asymmetric information concerning the properties of the product to be exchanged (Hidden Characteristics)

If, prior to the conclusion of the contract, the exchange partners have different information on the objective characteristics of the goods to be exchanged (for example in the market for consumer goods), this favors the process of negative selection. For example, there is a lot of information on the goods on the used car market, which can be unethical to the advantage of the buyer.

The problem of the hidden characteristics is found particularly in anonymous markets, in which buyers and sellers do not know one another, and are not dependent on one another because they will not do business again. The seller can thus deceive the buyer because of the asymmetric information, without having to fear retaliation if the buyer has identified the fraud. One thinks of the itinerant vendors who went from village to village, and so were never accessible. In decision theory, this corresponds to the game with one round. Anonymous markets can be financial markets, but also in big cities people do not know each other and often do not see each other again after buying. This is why, as a rule, crime is higher in an anonymous city than in a village. Despite the cliché of the country bumpkin who gets rolled in the big city, he is not more naive than the city inhabitant; he has simply not had bad experiences and is therefore more trustful.

Another area with the problem of hidden characteristics is personnel management.[56] For example, when a new employee is hired, the quality of the that person is not directly identifiable. Hidden characteristics are the qualities of the applicant, which are unknown to the employer when hiring, such as the actual degree of qualification, the integrity, the working attitude and loyalty. Hiring external employees therefore entails a high risk of failure assessment due to the hidden characteristics, associating it with high risks. It can only be recommended if no one is available internally at the time of hiring, or if external knowledge can be brought into the company that the company has no other way to access.

Ultimately, the importance of the corporate identity and, in particular, the emotional attachment of the employee to the company has decreased over the last decades. This has aggravated the principal agent problem. In the past, it could be expected that a company's management would have worked hard or at least learned about the most important value-added stages and corporate identity. This not only had the advantage that managers could better assess the impact of their decisions on the company, and they had a stronger identification with the company. Furthermore, the risk of failure due to hidden characteristics was less, because the management had to prove itself in the company for many years. However, the problems of hidden characteristics, hidden information, and hidden actions exist on every level of leadership down to the subordinate decision-making units.

Market Failures can Be Countered by

- Screening: the uninformed person improves his information level by gathering information directly or through advice from specialized third parties.

[56] See Berthel, Jürgern/Becker, Fed G. (2013), p. 48.

- Signaling: the better informed party provides information, for instance by offering a guarantee.[57]
- Morality: Ethical behavior in hidden characteristics would prevent the better-informed from betraying the worse-informed.

In German literature, there is still the distinction between trust and experience goods. In the case of experience goods, the customer knows the characteristics of the goods after the purchase, not in the case of trust goods. The commercial audit is, for example, cited as the trust good. In the case of trust goods, self-policing is an effective solution, such as by offering a guarantee.[58]

(B) Hidden actions

Since in general the one partner does not know how the other will behave after signing the contract, this favors possible hidden actions. The contract is then not implemented to the advantage of both sides, but the one side betrays the other and the allocation optimum is not achieved.[59]

This problem of moral risk (moral hazards) is seen particularly often in the insurance industry. The behavior of the insured person may change after the conclusion of the contract at the expense of the insurer, because he will no longer be liable for his property. After completion of the insurance policy, the insured person may, under certain circumstances, influence the probability of the loss occurring without the insurance having any influence on this. For example, the owner of a fully-insured luxury car might hope that he can order a new car if he parks it in a dangerous area. Incentives such as refunds can be used to prevent market failures.

There are hidden actions with rental, since the landlord does not know how the tenant will deal with the object after the conclusion of the lease. To reduce the risk, the tenant must provide a deposit. With moral behavior this would be superfluous and he could trust the tenant.

(C) Hidden intentions

The difference between the hidden intentions and the hidden actions is the intention. A contract partner has performed first and now depends on the other for the fulfillment of the contract. There is a one-sided dependency after conclusion of the contract.

Ignorance of the contractor's "covert intentions" can lead to the exploitation of contractual scope for interpretation by the economically stronger person to the detriment of a contract partner dependent on him (hold-up behavior).

This possible exploitation or blackmail could be attempted with a strategy of interest harmonization (incentives, such as profit sharing). Hidden intentions exist not only in leases, but also advance payment. The one-sided dependency is counter-

[57] See Dillerup, R./Stoi, R. (2011), p. 24; Welge, M./Al-Laham, A. (2008), p. 52 and Fritsch, Michael/Ewers, Hans-Jürgen/Wein, Thomas (2011), p. 263.

[58] See Ballwieser, Wolfgang/Clemm, Hermann (1999), p. 414.

[59] See Weisser, J. (2012), p. 53 and Alparslan, A. (2006), pp. 22.

acted here with deposits and guarantees. Risks from Hidden Intentions are also present in joint ventures for market closure, where a company has the know-how. The other partner could try to build his own company as soon as he has acquired the know-how. Here, harmonization of interests can be achieved by a very high participation of the partner in the joint venture. The participation must be so high that it is no longer worthwhile for the partner to build a second company. Again, it helps if one can trust in moral behavior.[60]

5.5.3 Market Failure Due to Transaction Costs

If market transactions fail because of their transaction costs, one can also speak of market failures in a broader sense.[61] Transactions can be understood as all transfers of rights to dispose of goods and services.[62] The transfer of services includes the internal sale of work through an employment contract. The transfers incur costs, such as information, negotiation, control and enforcement costs, as well as transport costs in a broader sense.

We distinguish between direct and indirect transaction costs.

1. Direct transaction costs

Over the past few decades direct transaction costs have fallen very sharply, leading to the formation of numerous new markets. Some factors in cost reduction have been the Internet, new transport techniques and English as an international business language. All together, globalization has been a key factor affecting costs. The world has become smaller because the paths have become shorter and more cost-effective. The invention of the Internet increased market transparency with reduced transaction costs. Prices and services can be compared faster and more cost-effectively. Innovation have been made in the transport techniques like container shipping, large oil tanks and reduced flight costs. The implementation of English as an international business language is comparable to the introduction of a uniform standard (e.g., metric or DIN). Translation costs are thus obsolete as people trade with other cultures, e.g. German and Chinese in a common foreign language. They have to learn only one language through the common standard in order to be able to do business.

2. Indirect transaction costs

If, as with the asymmetric information presented, the fulfillment of the contract is uncertain, there is a risk of loss. This is always the case if behavior after contract conclusion cannot be controlled absolutely. This is relevant for all forms of transac-

[60] See Dillerup, R./Stoi, R. (2011), p. 25 and Welge, M./Al-Laham, A. (2008), p. 53.

[61] See Williamson, O. E. (1979), pp. 18 and Williamson, O. E. (1985a, b) and Furubotn, Eirik G./Richter, Rudolf (2005), pp. 47.

[62] See Gabisch, Günter (2003), pp. 56.

tions, which include long-term contract fulfillment, thus also employment contracts. The higher the advance performance and the longer the contract duration, the higher is the risk of a lower counter-performance. This applies in particular to investments by companies in new production facilities, for example. Here, the investment is high but the return is distributed over many periods. These indirect transaction costs can be reduced by an objective and rigorous legal system. A written Code of Law also reduces the risk and is better than a case law because case law builds on precedents. Countries that do not have a reliable law enforcement system have difficulties in attracting direct investment.[63]

The indirect transaction costs can be reduced by strong morals. Luhmann also sees trust as a means of reducing the complexity of social interactions. If the culture of a country is moral, the contracting party can trust in the implementation of its treaties.[64] There is no longer a risk of fulfillment resulting from being taken advantage of.

Transactions are completed when the indirect transaction costs are reduced, which can be considered its own business approach. Phrases like “A good name is worth its weight gold” and “My word is my bond” as well as the legal concept “good faith” stand for this approach. The reputation of a person or a company includes everything associated with its name: poor or good performance, moral or immoral behavior, etc. A reputation is formed by acts that are observed and interpreted by people, by the market. This means that every company is responsible for its own reputation.

The honor of the merchant also derives its significance from the elimination of the risk of contract settlement. This honor was institutionalized by merchant guilds. They introduced codes of ethics and sanctioned corresponding rules. Grievous violations were punished with exclusion from the guild, which was equal with the abolition of the entrepreneur’s livelihood, because he lost the trust of his business partners.[65] Even in Mafia circles there is an honorary code within the criminal organization and their business partners. Thus even criminal circles need a minimum of morality to deal with their business transactions. They also need mutual trust.

Trust

After the Enron crisis nobody trusted the balance sheets of companies. A result of the subprime crisis was that nobody trusted banks anymore, the confidence was lost, and this would have caused the world economy to collapse without state intervention. What role does trust play for people? If people are descended from apes, we may assume they have similar group dynamics. Apes are extremely rarely solitary animals without connection to a group. They must find a place for themselves within a hierarchy and are dependent on the grace of other group members. For example, the gorillas have a “silverback” who leads the group as the dominant male.

[63] See See Steinherr, Christian/Steinmann, Horst/Olbrich, Thomas (1997), p. 1.

[64] See Luhmann, Niklas (2000).

[65] See Beschorner, Thomas/Hajduk, Thomas (2011); Albach, Horst (2003) and Lin-Hi, Nick (2014), pp. 10.

Chimpanzees have displayed political behavior. Only the ape with the strongest faction of followers behind him can dominate the group, thus a relatively democratic majority. The apes must exhibit a minimum of cooperative behavior, which appears coded in human genes as well, otherwise groups would not be created and solitary apes and humans would be common in nature. Reality shows us that this predetermination is not always sufficient to secure cooperative behavior. The incentive to act uncooperatively must be correspondingly great. This comes from the fact that many decisions are made within daily dilemma structures, such as the prisoner's dilemma. The dilemma consists of the fact that the total benefit is greatest for those involved in cooperative behavior, yet insecurity over cooperative behavior from others allows non-cooperative behavior to seem the best choice for individuals. The worst result for the individual would be if he acts cooperatively while the others all act uncooperatively. On the other hand, the additional benefit for the individual is greatest if he is the only one to act uncooperatively. Since everyone is subject to this situation of insecurity, everyone decides to behave uncooperatively, which provides the worst results for everyone. An example from the decision-making situation on the market: a buyer buys a good that he has not tested and does not know. The seller trusts that when he sends a bill he will be paid later, after the goods have been delivered. If neither of them can trust the other one, they will assume that the other one will cheat them. The consequence will be that each one cheats the other in order not to make the purchase worse, that business does not occur at all or that there are high safeguarding costs. In business with unknown foreign business partners for example, it is common to conduct transactions step by step with the guarantee of a bank (e.g. payment only in exchange for documentation or with a confirmed bank credit, letter of credit).

This kind of dependency and dilemma situation is particularly problematic if not all of the actors know each other (on anonymous markets), cannot vote or if there is a one-sided dependency, in which the decision-maker can later punish non-cooperative behavior. It is best if the people acting directly can be trusted. With morality and good manners as a basis for societal trust, cooperative behavior has a foundation, which in turn allows these values to increase productivity.

Trust is nothing more than believing that someone will behave as expected without sanctions. Trust exists in relation to good performance, moral behavior, help etc. Ethical behavior is an elementary prerequisite for human cohabitation. If one wishes to pursue common goals in a marriage for example, such as providing for each other and raising children together, the basis must be mutual trust. Without ethical, moral behavior there can be no trust between the spouses. Behaving ethically in this context, according simply to our definition, means not to damage the other party, or to be of use. Trust for companies is also important. Companies enter into transactions with new, unknown business partners because they have a good reputation. A good reputation engenders trust. As we saw in Chap. 3, if transactions occur only once, and so anonymously that damage to one's reputation is not expected, it would maximize one's advantages to fleece the business partners. The reputation of a person or company includes everything associated with them. Good or bad performance, moral or immoral behavior, etc. A reputation is made up of actions that both people and the market observe and interpret. Every company is thus responsible for its own reputation.

Citizens can trust in laws, courts and the executive branch. But as we have already mentioned, no system can control and implement the rules 100%, no matter what efforts are undertaken. Rules help in particular when they are clear and transparent, known by all actors, and everyone involved assumes a consistent application of the rules.

Absolute control is impossible, which means that unethical behavior can pay off. Why then, do people generally behave fairly and ethically? How can we explain this "irrational" behavior? Is it deterrence or are people as social animals programmed that way? Both answers are elementary for moral behavior, but there is also the element of socialization, which teaches us how to live in our communities. Socialization as practicing behaviors and beliefs takes place mostly in childhood, but continues throughout our lives as long as people are in groups where they are at least partially in a dependent relationship. Behavior in conformance with the group is demanded of individuals. Sanctions are applied here as well. They can range from a refusal of recognition to exclusion from the group. People generally continue the behavior they have practiced even if the sanction is removed. Moral behavior must be practiced just like driving a car. The traffic laws provide the framework of behavior, and for interpersonal interaction there must also be rules with sanctions. The continued learning of the correct, or socially desirable, behavior begun in childhood creates a conscious value system in people as the foundation of their own goals and actions, which enters into the subconscious through constant repetition. Based on this subconscious set of values, we act as unconsciously as we drive a car, without having to reflect anew. Sanctions become superfluous. For the community this means that values must be passed on and socialization must take place in the youth. Role models are also important. They communicate beliefs that offer an explanation for behaviors. The disposition towards certain types of behavior are inherited, varied and cannot be influenced. If we want to influence people positively with business ethics, we must start with social, economic or business role models for socialization and communicating beliefs and attitudes.

Trust is an absolutely central economic factor both at the level of the individual and the whole economy. Who would want a business partner they cannot trust? How does it help a customer to be consulted by the best bank, the market leader, and have the feeling that all this intelligence and experience is working against him in order to empty his pockets, perhaps even recommending investments that will permanently damage him? The bank could recommend poor stocks still on the books from an IPO that made it a lot of money, and which the bank now wants to get rid of. Or someone could sell him life insurance with large fees hidden in small yields later on. Let's say the customer had already taken out two life insurance policies. What he cannot know is that the bank forces its consultants to sell at least five life insurance policies regardless of whether the customer needs them or not. Loyalty and confidence, or morality and ethics, are thus an important part of any service and a competitive advantage for companies on transparent markets. Once a customer's trust has been violated, if he acts rationally he will change banks, and as soon as he finds a bank he can trust he will stay there. For the bank that lost his trust he is lost forever, making the profits from the strategy with short-term success much less over the long term. The ethics campaign of Citibank, once the largest and most profitable banks, thus makes sense not just because of the imposed fines, but because the bank recognized that it went too far with its sales methods. It went so far in fact that the damage to its reputation and customer satisfaction could damage its future market position.

We have already discussed the importance of moral values for national economic development. The same applies at the microeconomic level for each company. A company that must operate in an immoral environment (such as in Russia) will have higher transaction costs. It must monitor and protect itself more. This causes inefficiency, since many economic transactions are lost to higher costs and risks. A company acts in a given social framework and recruits its employees from this society. Suppliers, customers, the legal system… everything comes from this society. The possibility for a company to influence a society is very limited, the opportunities for influence are trade associations, thus politics or advertisement. The most important thing for the company is to acquire morally suitable employees, and to hold them to moral behavior, whereby management focused on qualitative goals plays an important role, as we will show later on.

A survey of 500 employees of European companies showed the great importance of trust in ethical behavior. If employees can trust their executives, they are more ethical. Empirical behavioral experiments also confirm this.[66] The gift exchange game or trust game, which builds on the ultimatum game:

Game 4: Gift Exchange Game or Trust Game
Two students are to split 10 pieces of chewing gum, as they did in the ultimatum game. The first (proposer) receives everything and can determine how much he gives to the second. This amount is then tripled. The second (responder) can then decide how much he will give the proposer.

The Gift Exchange Game or Trust Game is normally played with $10 instead of chewing gum. Rational behavior presupposes that the proposer should keep all money because, as a rational actor, he also assumes that the responder will give him something afterwards. After all, it is a game with one round. In the games, however, only a small proportion has chosen this strategy. Most of the proposers had confidence in the unknown responder and were rewarded because of the strong correlation between the amount of money transferred and the subsequent responses of the responder.[67]

After the Enron crisis (see also Sect. 4.1) confidence in the company's balance sheets was shattered, and as a result of the subprime crisis no one trusted the banks, while the banks trusted themselves least of all. Confidence was lost, which almost collapsed the global economy. What role does trust play for people? If the human being is descended from the monkey, similar group behaviors may also be applied

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[66] See van den Akker, Lenny/Heres, Leonie/Lasthuizen, Karin/Six, Frédérique (2009).

[67] See Holzmann, Robert (2015), p. 129.

to man. A solitary existence is a rare exception in the life of monkeys. They have to adapt themselves to predetermined hierarchical levels and rely on the favor of the other group members; this political behavior has even been observed in chimpanzees. The only monkey able to dominate the group must be able to unite the strongest group of supporters, a relative democratic majority. A minimum of cooperative behavior must therefore be applied to monkeys and thus also be a genetic attribute in humans. Otherwise no groups would form, and both monkeys and man would be observable in nature only as solitary individuals.[68]

Reality shows that predetermination is by no means sufficient to ensure cooperative behavior. The incentive to behave non-cooperatively must therefore be correspondingly large. One of the reasons for this is that many decision-making situations in everyday life have a dilemma structure, such as the prisoner's dilemma presented above.[69] The dilemma is that although the overall benefit from cooperative behavior is greatest for the stakeholders, the uncertainty about the cooperative behavior of others makes non-cooperative behavior the best choice for the individual. The worst result for the individual is if he is the only cooperative player and all others uncooperative. Vice versa, the profit-gain is greatest for the individual if all others behave cooperatively. Since the insecurity in the situation is about everyone's behavior, they all opt for non-cooperative behavior, which is the worst result for everyone (ethical prisoner dilemma, see also Sect. 6.1). Here is an example from a decision-making situation on the market: The buyer buys a product which he has not yet been able to try out, or does not know. The vendor will rely on the buyer to pay for it later, after the delivery of goods. If neither one trusts the other, they will have to assume that they are going to be cheated. The consequence will be that they are also cheating, in order not to suffer from the purchase, so the business transaction is not concluded or high hedging costs arise. For example, in transactions with unknown foreign business partners, it is customary to carry out the transactions step by step with guarantees from a bank.

Dilemma and asymmetrical information are problematic, especially if the persons who are acting are not familiar with one another (on anonymous markets), cannot vote, or if they are dealing with a one-sided dependency in which uncooperative behavior can not be sanctioned later (play with one round). It is even better, then, to trust the active man directly. In the case of morality as a social basis for trust, cooperative behavior can be assumed, which is why these values are productivity-enhancing.

The importance of moral values for economic development has already been demonstrated. The same applies microeconomically to each individual company. An enterprise that has to operate in an immoral environment (as in Russia, for example, due to the uncertain legal situation) will have higher transaction costs. It must control more and secure more. Efficiency suffers, and many economic transactions are avoided because of higher costs and risks. A company moves in a given social context. It recruits its employees from this company. Suppliers, customers, legal

[68] See Windeler, Arnold (2014), p. 175.

[69] See Kirchgässner, Gebhard (1991), pp. 51.

order – everything comes from this company. The possibility for a company to influence society is only very limited by economic associations, such as politics or advertising. In the short term, it is also important for the company to acquire morally responsible employees and to educate employees on moral behavior, whereby a quality-oriented management plays an important role, as will be shown later.

Summary
Asymmetric information gives the advantage to the informed contractor over the uninformed and enables him to betray the uninformed contract partner. Reputation, trust, and morality have evolved as a social solution to this problem.

Comprehension Questions
1. What is asymmetric information?
2. What effects can this have on business relations?
3. Give examples of the economy in which asymmetric information exists and possible tools to prevent unethical effects.

5.5.4 Market Failure Due to External Effects

External effects are the consequences of economic action on the welfare of an uninvolved third party whose interests are not expressed in market prices (definition), which is why they have an ethical dimension. Negative external effects are immoral because they cause harm. If the state wants to prevent others from being harmed, it must internalize negative external effects through taxes or positive external effects through subsidies.

External effects are thus effects which originate from economic subjects and are not internalized by the market mechanism. As a result, the incentive system is also distorted. Negative effects (negative external effects) are not sanctioned by the market and positive effects (positive external effects) are not remunerated, resulting in a suboptimal resource allocation. For example, environmentally damaging products, such as plastics, are not burdened with the welfare costs that cause their disposal, which is a negative external effect.

Negative external effects (social costs) harm a third party. Some examples are exhaust gases, noise, waste water, damaged the environment and thus the welfare of third parties. The injury is not included in the production costs and thus does not burden the victim. Positive external effects (social benefits) favor third parties. For example, a park in a large city or the maintenance of the buildings increases the value of neighboring buildings. In this case, the positive effect is measurable because it manifests itself in the appreciation of the land value.

External effects cause misallocations because not all costs or benefits are reflected in the market prices. Since the providers and buyers appearing on the market only take individual advantage into account in their decisions, the market profit is not efficient from an economic point of view.

Exhaust gases, mostly CO_2, are produced during the operation of airplanes, damaging the ozone layer. Layers of the atmosphere are destroyed and the level of noise makes life near airports almost impossible. These effects are not included in the operating costs of the aircraft, which leads to a misallocation. Due to the high negative external effects, the flight prices would have to be substantially more expensive. The price does not cover the cost, which is why too many flights are in the air.

The education of the population, on the other hand, has positive external effects. In the long run, education leads to a higher productivity of the population and thus to higher tax revenues, which is why the free education system pays off for the state. Furthermore, as already shown in the social market economy, an educated population is not as vulnerable to opinion manipulation and unilateral extremist slogans, which stabilizes democracy. Overall, there is a higher welfare of the population through education.

There are ethical solutions for external effects. Moral behavior requires that third parties are not harmed. Thus an ethically oriented company would either have to stop the production with negative external effects or at least compensate for the resulting damage. However, if there is no binding regulatory framework internationally, this would mean that moral behavior is associated with major drawbacks, because it entails competitive disadvantages. This places the national governments in a prisoner's dilemma. Environmental pressures in the national market are, at the very least, short-term competitive disadvantages. The uncertainty about the behavior of the others leads to the collective worst case, insofar as no environmental requirements are implemented.

The state has developed external effect standards and sanctioned external effects such as telephoning with mobile phones on the train or smoking in restaurants. Socialization and parenting are key factors here. There are also behavioral guidelines such as "What you do not want to be done to you, do not do to others", which corresponds to the categorical imperative of Kant. It is also possible for people to take care of others, and to try to avoid negative externalities and to support positive ones.

5.5.5 *Market Failure Due to Corruption*

The market economy generally has a system of rules for playing the game that must be learned and controlled. Especially immoral behavior can damage the system in this context. The most famous example of immoral behavior and systemic behavior is corruption.

Case Study: Does Corruption Pay? The Example of Siemens[70]

1. Discuss the following article in the group. Why is there always corruption and why does it not pay off in the long term? Why is corruption harmful? What measures would you recommend to a company to prevent corruption?

Siemens, as one of the largest exporters of industrial equipment and train systems, maintained a widespread system of corruption. It was decentralized with the tacit approval of the group headquarters. There were a multitude of opaque transactions, insider cliques, and hundreds of accounts abroad in the many divisions and countries of the world conglomerate. The investigations of the American lawyers commissioned by the Siemens Supervisory Board, as well as the Munich public prosecutor's office, showed that between 2001 and 2006, bribe payments of at least 1.3 billion euros had flowed through those bank accounts. The recipient and the purpose of the payments are partly unknown to date.

It turned out that many orders, apparently acquired with bribes, were unprofitable. The Italian energy supplier Enel was responsible for the kick-off of Siemens, although the turbines were scarce and had to be allocated. In Argentina, the governments of Menem and de la Rúa were bribed. However, the announced, and in some cases contractually agreed, major contracts did not come about. Instead, there was blackmail on the part of the Argentinians who were involved in the distribution of orders, as they demanded money for the silence on the bribe payments. Siemens employees in Argentina reported life-threatening difficulties. Thus the seemingly lucrative business became a nightmare and a loss in business.

The US SEC initiated a corruption case against Siemens in the United States, as Siemens is listed on the US stock-market. The Siemens Supervisory Board had then instructed a law firm in the US to investigate the Group and pass the findings directly to the US stock exchange supervisor. It turned out that there were far more questionable payments than the board had initially reported. In the middle of November 2006, the Munich Public Prosecutor's Office carried out a big raid at Siemens. In 2007, Siemens was threatened with the exclusion of public contracts on the world's most important markets, huge image damage and billions in penalties. Siemens decided to make uncompromising reconnaissance and practically exchanged its entire management. At the same time, a comprehensive compliance system was set up. Siemens came away with an asset loss of an estimated 2.5 billion euros, of which were 1.2 billion euros in punitive payments. In 2008, the SEC imposed a fine of $1654 million on Siemens for the bribery of public authorities in several countries on the basis of the American Foreign Corrupt Practices Act (FCPA), of which $350 million went to the SEC, $450 million to the US Department of Justice, and

[70] Sources: http://www.faz.net/aktuell/wirtschaft/unternehmen/bestechende-grossunternehmen-korruption-rechnet-sich-nicht-12050962.html?printPagedArticle=true#pageIndex_2; http://www.zeit.de/online/2008/51/siemens-korruption-strafe; http://www.sueddeutsche.de/wirtschaft/korruptionsaffaere-siemens-akzeptiert-millionen-dollar-strafe-1.372394; http://www.manager-magazin.de/unternehmen/industrie/siemens-zehn-jahre-nach-dem-siemens-skandal-a-1118197.html; http://www.handelsblatt.com/unternehmen/industrie/der-fall-siemens-sec-klopft-bei-staatsanwaltschaft-muenchen-an/2805400.html

$854 million went to the German prosecutor's office. The CEO of Siemens von Pierer maintained he had not known anything about the bribes. Pierer stepped down from his post. He was not prosecuted under criminal law, but had to pay damages of €5 million. A prosecution against him for neglecting the duty of supervision was suspended for a fine of €250,000. He then worked as an honorary professor and served on a supervisory board.

Private corruption is the abuse of a position in a private organization by using the position for one's own purposes and under public corruption we understand the abuse of a public office (definition).[71]

The advantage is difficult to detect and can be hidden behind apparent powers, such as consultancy fees or excessively high prior-day auditors.[72] Personal contributions are used to influence an individual in his market decisions. Market economy as a system generally has rules, which must be learned and their implementation must be monitored. Immoral behavior can damage the system in this context, and the most well-known example for immoral and system-damaging behavior is corruption. The individual is influenced in his market decisions by personal benefit. The corrupted individual no longer makes decisions according to objective market criteria, which cancels out the market and competition functions, including the invisible hand. The person no longer optimizes in the interest of the whole system, and can thus damage the system and others.[73] If, for example, the buyer for a company were bribed by a worse and more expensive supplier he would damage the company, the market economy system and thus the entire community. The company would then have to pay out more for the same amount in preliminary production than if it had bought the objectively better product on the market, the result is production of fewer goods. As a whole the company then produces more expensive preliminary products of a poorer quality and fewer goods. This is damaging for the company, the national economy and the community. Research in 97 countries in 1997 showed a negative statistical connection between corruption and GDP as well as between corruption and growth of the GDP.[74]

There are authors who regard corruption as a voluntary bargaining act, in which both sides win, whereby the redistribution cannot be assessed at the expense of the principal.[75] Corruption advantages are attested to by the bribe money as so-called Speed-Money. An inefficient situation created by slow bureaucracy uses the money as an incentive to get involved, thus making the situation more efficient. It is either assumed that the bureaucracy is ineffective or that efficiency is increased by corruption.[76] This implies that the bureaucratic rules are either nonsensical, inefficient,

[71] See Pritzl, Rupert F. J./Schneider, Friedrich (1999), p. 312.

[72] See Göbel, Elisabeth (2010), p. 300.

[73] See Graeff, Peter (2002), p. 295 and Homann, Karl/Blome-Drees, Franz (1992), p. 163.

[74] Corruption gross domestic product correlation coefficient: –0.80, statistically significant with a t-ratio of −13.2. Corruption gross domestic product growth correlation coefficient: –0.32, statistically significant with a t-ratio of −3.2. See Jain, Avid K. (2001), p. 90=.

[75] See Homann, Karl (2003), p. 242.

[76] See Graeff, Peter (2002), p. 296.

or that the officials would not apply the rules without corruption. Then the state apparatus would be an obstacle to the economy and thus better off done away with entirely. If one presupposes meaningful activity however, corruption creates an incentive to act corruptly. The decisions of the bureaucracy are at least no longer objective when corruption is involved.[77] They no longer represent the interest of the state or they give preference to companies that pay more, which leads to distortions in competition. We then have to ask who is paying the price of corruption. Bribery only pays off when it offers a greater advantage. As a rule, the damage is much greater than the benefit of bribery. Thus the damage to a bribed official who allows a drug that harms the general public is many times higher than the benefit to the pharmaceutical company.

It is in fact likely that bribery will make bureaucracy more expensive and will not make it more efficient because a corrupt official will try to get the maximum out of an administrative monopoly. A saying from China is "official and rich" and in the Philippines an official was paid up to $ 75,000 for an item that was valued at $ 10,000.[78]

Corruption is also partly classified as a voluntary contract, and therefore considered positive. However, the price and the bribe are, as shown above, at the expense of others, which is why corruption is unethical. While it is pointed out in the literature that a relationship of trust is established between the briber and the bribee of the exchange contract, this trust in the benefit, the maximization of the utility, is limited by the bribery. The briber can not usually prove that he has paid for something, and the bribery contract is not enforceable. The immorality in the abuse of trust that the bribed man commits is much easier to prove. A third party (state or company) has entrusted him to carry out a task, paid for it and yet was harmed. The fact that the payment offered was not enough cannot be used an argument, unless bribing was open to the contract between the principal and the agent. The bribee has voluntarily entered into the contract. Corruption is, therefore, first and foremost a breach of trust, and therefore repels many people. For Kant it would be dishonesty, a defeat, and a significant weakness of personality or character. Corruption violates all three Kantian rules of reasoning (categorical and practical imperative as well as publicity rule). Someone who breaks a trust at the expense of the one who trusted him to maximize his financial advantage, can no longer be trusted.

As already described, corruption is the misuse of a position in a private or public organization for one's own purposes. This includes nepotism, the abuse of the position for relatives or friends. Using relationships for advantageous deals or even name-dropping sound familiar and unproblematic, but the effect can be the same as with financial corruption. It depends on whether the relationship provides an information advantage, a higher transparency for the principal because it gets a person or a product that is better, or whether the person or the product is worse, and can only be accepted because of the relationship. Then there is no advantage for the principal, but a disadvantage through the relationship.

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77 See Pritzl, Rupert F. J./Schneider, Friedrich (1999), p. 322.

78 See Pritzl, Rupert F. J./Schneider, Friedrich (1999), p. 322.

The greatest negative effects of the development of corruption are found in the social impact on the society. Performance is no longer the decisive factor in improving one's own situation, but rather relations allowing nepotism and bribery in daily life, including the purchase of offices. Objective private or state decisions are made impossible by personal advantage and outside influence, which also has a long-term effect by lowering economic power. Foreign investors shy away from countries with strong corruption because they no longer have legal certainty.[79] Corrupt politicians and officials promote the uneven distribution of wealth as money leads to political power and vice versa. Money becomes the greatest factor in the system, thus displacing democratic decisions at the expense of the population who are excluded from the decision-making process. The distribution of wealth becomes more unequal.[80] In the Bible, bribery is severely condemned not only by a sense of justice, but also as a purely egoistic behavior against divine human dignity. The individual is enriched at the expense of the public.[81]

The unethical effects of corruption lead to the disintegration of the common system. If the acts are not punished, they will soon be imitated. It is always worthwhile for two parties to engage in corruption if they can benefit to the disadvantage of a third party. The incentives of corruption are quite strong and without sanction. There are plenty of arguments that play down damage to the third person and make it easier to avoid a bad conscience. This business, in which both parties profit greatly without much effort, finds imitators and, according to Kant's categorical imperative, multiply until the common system no longer works. That is, the culture is eroded as a basis for a productivity-enhancing division of labor. The damage to third parties is borne by the public through bribed state officials, the expense to the owners of companies as well as indirectly at the expense of all employees, insofar as the company is weakened. Overall, the company has less profit to be distributed.

Corruption is also unethical in the sense that it undermines the advantages of the market economy in the function of competition. The distribution becomes unfair because equals are given unequal reward. Performance is no longer crucial to success.

Since corruption not only affects the national economy, but also the companies themselves, Transparency International has compiled recommendations for companies on corruption prevention.[82] Transparency generally recommends companies involved in bribery to be listed in an anti-corruption register and to exclude them from the award of public contracts for several years.[83] However, this sanction would affect only a part of the companies, since not all of them participate in public contracts.

[79] See Graeff, Peter (2002), p. 298 and Lambsdorff, Johann Graf (2002).

[80] See Pritzl, Rupert F. J./Schneider, Friedrich (1999), pp. 322.

[81] See Pritzl, Rupert F. J./Schneider, Friedrich (1999), pp. 324.

[82] See http://www.transparency.org/whatwedo/pub/assurance_framework_for_corporate_anti_bribery_programmes, http://www.transparency.de/fileadmin/pdfs/Themen/Wirtschaft/Checkliste_Self-Audits_TID.pdf (4.04.2013).

[83] See http://www.transparency.de/Stellungnahme_Entwurf-Gesetz-S.2338.0.html

Internationally, there is a trend towards a tightening of corruption regulations. In response to the Watergate scandal, the U.S. issued the Foreign Corrupt Practices Act (FCPA) in 1977, which punished the bribery of foreign public officials by American corporations and citizens internationally. Since other countries did not follow, and Germany partly promoted the bribery of foreign companies to support exports, the FCPA initially had a negative effect on the competitiveness of American companies. In addition, all companies listed in the US are obliged to adjust their accounting to the anti-corruption rules of the FCPA.[84]

In 2008, the SEC imposed a fine of $1654 million on Siemens for the bribery of public authorities in several countries on the basis of the American Foreign Corrupt Practices Act, a settlement of which is $350 million went to the SEC and $450 million to the Ministry of Justice. $854 million went to the German government. The profit from these transactions, however, amounted to $1.1 billion for Siemens.[85]

In 1997, the OECD adopted a "Convention on Combating Bribery of Foreign Public Officials in International Business Transactions" signed by all 29 states with an obligation to incorporate the content into national law. This law, however, only regulates the bribery of foreign officials and presupposes that a breach of service duty can also be proven. This law was only ratified in Germany.[86]

The United Nations Declaration against Corruption entered into force on 16 September 2005. It is the first international treaty to fight corruption. The contracting parties undertook to punish various forms of corruption against officials and international cooperation. After persistent public criticism, the Bundestag passed a tightening of the rules of parliamentary deputies in 2014. A convicted deputy will be punished with up to 5 years imprisonment.[87]

Corruption is punishable for individuals, but not for companies. The introduction of criminal liability for legal persons and associations of persons failed to take hold in 1998. If a company commits a criminal offense, this is treated as an administrative offense.[88]

Bribery or attempted bribery in private business transactions is punishable for instance in Germany according to StGB §299 with imprisonment up to 3 years or with a monetary penalty. It also punishes whoever is or is trying to bribe employees or agents of a business enterprise. StGB §344 stipulates the punishment of the bribery or attempted bribery with an imprisonment of 3 months to 5 years.

Since corruption is not public, it is difficult to measure. Transparency International uses the Corruption Perceptions Index (CPI) to measure the corruption perceived in the public sector. However, this is not a direct, comprehensive measurement, but an aggregation of various studies and studies from a number of independent and

[84] See Pritzl, Rupert F. J./Schneider, Friedrich (1999), p. 329 and http://www.justice.gov/criminal/fraud/fcpa/

[85] See http://www.sec.gov/news/press/2008/2008-294.htm

[86] See Elsner, Ulrike (2012); Keuchel, Jan (2002); Göbel, Elisabeth (2010), p. 300 and http://www.gesetze-im-internet.de/intbestg/BJNR232729998.html#BJNR232729998BJNG000100305

[87] See http://www.transparency.de (4.04.2013) and Deutscher Bundestag Drucksache 18/476.

[88] See Bundesrechtsanwaltskammer (2013).

well-known institutions. The countries are listed according to the degree of corruption in the public sector. According to Transparency International, the CPI is the most widespread corruption indicator in the world.[89]

Conclusion
Corruption acts as a reward for an expected risk, such as moral hazards, thus as incentives directed against the interests of the company or the community. Immoral behavior presents the greatest negative impact for top managers for stakeholders and shareholders. The company's success is jeopardized by immoral behavior. Moral, ethical behavior is therefore very important for the company. The same applies to the companies among themselves and in competition. Only a fair performance competition ensures an optimal allocation of resources and thus an efficient overall economic production. Immoral behavior harms society generally, from market processes, internal business processes and the erosion of culture.

The subprime crisis has shown that a market system without rules and controls cannot function. Although capitalism, or the market economy, is responsible for many crises with its growth and individual freedom, it remains the best of all possible economic systems. It is much more crucial that rules and controls exist to prevent damaging individual behavior. The regulatory concept of ordoliberalism has prevailed against the laissez-faire liberalism. Additionally, society has to implement moral responsibility in order to get a functioning market system.

Comprehension Questions
1. What is corruption?
2. Why is corruption harmful?
3. To what extent is corruption punished?
4. Identify the forms of market failure and explain to what extent morality is necessary here.

5.6 Morality Within the Economic Division of Labor

The decisive question is thus which soft facts are relevant for productivity in a company and national economy and how they can be used. To be more exact, how can the natural tendencies, motivations and desires of employees be applied for the good of the company and other employees? What would this kind of management or company approach look like? First we want to define a company more precisely however, what its functions and special features are. Let us consult academic science. Institutional economics defines a company as "a coalition of resource owners bound by a nexus of contractual relations that is governed by a contract decision and monitory agent – the entrepreneur."[90] This definition describes the composition of a company, but does not really address its core. According to Coase, the function of a

[89] See http://www.transparency.de (4.04.2013).
[90] Quoted from Nowak, Eric (1997), p. 22.

company is to avoid transaction costs. This would make companies a unit that regulates repetitive transactions internally and externally through long-term contracts, which would then save transaction costs. Adam Smith recognized companies as a means of organizing labor distribution and thus taking advantage of the learning process, which simplifies production and using the individual strengths of the employees. Alchian and Demsetz later stress this aspect and identify team production as the main function of a company, as did Wieland.[91]

The decisive characteristic of a company is neither long-term contracts nor team production, but organization in and of itself. A company does not have to produce in a team to make profits. A bus company for example, is made up of many individually operating transportation units that are completely independent of one another. There is no team production here. The important value creation in this case is the organization of buses or bus routes. We define organization as the systematic assignment of functions into a whole capable of action (definition). In our example this would be the assignment of routes to the individual buses and drivers, thus assigning functions to people and machines. Within the framework of the company organization the employees receive tasks and decision-making powers. This organization of productive forces provides productivity, from which comes the added value of the organizational form "company." The art is thus in an optimal assignment of functions to employees and machines. The productive force of the company is hidden here. For example this is why job descriptions in a company (tasks and abilities) must be matched with the capabilities of the employees.[92]

Why is there human culture? Only because the mathematical principle of $A + B + C = 1 \times (A + B + C)$ is disproved by life in human communities. If a group of people join forces for a common task the result of the common action is greater than the sum of the individual actions (emergence). The sum is greater than its parts, which is a human wonder because it contradicts mathematical law. In the end organizations are nothing else but societal solutions to problems that they have developed in answer to external demands and conditions. Over time social constructs come into being, which create added value through the cooperation of different people. For these people to create an added value cooperatively, several challenges must be overcome. Suitable rules for potential conflicts must be found. In companies this often takes the form of the long-term contracts mentioned. Not only do they reduce transaction costs by regulating performance and compensation between the employer and employee of the long term, which encompasses the social inclusion of the actors in team production, but they also regulate the power to make decisions and thus all internal rights and duties including the distribution of added value created in the company as income.

Social rules are called institutions in Sociology. In contrast to the organization, an institution does not create direct added value, but it is an important requirement to do so. Institutions have been created over time to overcome societal dilemma

[91] See Alchian, A. A./Demsetz, H. (1972); Nowak, Eric (1997), S 19ff and Wieland, Josef (1999), pp. 54.

[92] See Vahs, Dietmar (2001), p. 62 and Conrad, Christian A. (2010).

structures, such as the state legal system. A social dilemma comes from the fact without a state framework for order, it would be worth enriching one's self at the cost of others. For example, not even a bridge could be built with the guarantee of ownership, because the construction site would be constantly plundered. If only the law of the strongest applied, property would not be obtainable through labor, or at least one could not keep it, which removes a central motivation to work. Without institutions many added social values would not be obtainable.

Another social construction that creates added value is cooperative networks. These are practiced forms of cooperation or generally supportive interactions amongst many people, which create added value. Every team is a cooperative network; repetitive labor is delegated within a team and practiced in cooperation together, for example. Every team member knows what output is received from each partner. The decisive factor is the added value possible through this cooperation. The cooperation between the network members can also include the exchange of information. The added value then comes from decisions made that are more in touch with reality.

Companies are generally made up of several interactively cooperating networks that are included in the organization as an assignment of functions. Cooperative networks also exist outside of companies however. The first such networks was probably founded in hunting groups in the Stone Age. Only together was it possible to herd wild animals or kill a large beast. A soccer team is another example of a cooperative network that is not a company. A soccer team can be created spontaneously, which makes clear that long-term contracts are not imperative for cooperative networks. An informal, mutual agreement is sufficient. Since most cooperative networks are designed to be long term, such contracts are the rule. For all social constructs based on mutuality, at least an informal agreement is required for cooperation. Otherwise the members of the network would not agree to advance concessions with their cooperation, since they are usually expecting compensation. Let us resume: Cooperative networks are social constructs, just like institutions and organizations that have been created in the society over time to create more added value through group cooperation. Cooperative networks are the first level of cooperation if measured by complexity. Organizations give structure to cooperation, putting the cooperative networks in a more complex order and hierarchy, so that more complex processes can be structured securely over the long term. Long-term contracts are necessary for this. Institutions make cooperation possible as rules that provide a framework. In principle this is nothing more than the best possible application of all productive forces, the combination of humans and machines. With this background the necessity for hierarchies is given for purely functional reasons, to coordinate processes from above and to bundle the flow of information from below upwards.

There is no corresponding example in nature for the differentiated labor distribution in human culture. Take the comparison with ants. Ants do not have differentiated possibilities for communication, nor do they have a central decision-making body that can collect and evaluate information in order to make decisions for the group. Despite these differences, the following has been observed in ant colonies: a) they raise and milk aphids, b) they grow trees suitable for their housing by destroying the seedlings of other trees c) they collectively build bridges over rivers and d) together they build living rafts in case of a flood. These are also repetitive behaviors, yet they are not consciously designed and then practiced. They must be the product of evolution. Certain inborn behaviors offered survival advantages over other species, and with this programming they were able to solve problems in a decentralized manner and were able to gain the evolutionary advantage compared to other insects. All of the estimated ten trillion ants, including 12,000 species, amount to as much biomass as the humans living on earth.[93] Recent observations have even led to the supposition that ants have at least a certain degree of cognitive abilities. There is one species of ants for example, in which it was observed that the older ants showed the younger ants the way to food sources.[94] We can conclude from this that decentralized solutions to complex tasks, or decision-making at lower levels taking superior company goals into consideration is indeed possible without consulting a higher instance. This assumes however, that the employees have a character like that of the ants. This would include knowing the goals of the company and the morality, or better said the willingness to follow them without supervision.

We have now worked out two important components of companies, first cooperative networks that are, second, embedded in an organization. Another important component is the human capital of the employees. If one put together a company with just any employees without paying attention to their characteristics, it would not be functional. Human capital can be understood here as all of the prerequisites and potential for added value creation in which people are involved and incorporated as productive forces. We can differentiate here between social capital and individual capital.

Social capital is all of the prerequisites for productivity a person has, but only in a group, thus social in the sense that they can only be realized within a society. The practiced cooperative and informative behavior of members in cooperative networks is social capital, because it can only provide an added value through the interaction with other people. Another example for social capital is practiced social behavior, including virtues, morals and politeness. The social added value that is only created with others comes from a reduction in the transaction and control costs of all social activities. The so-called honorable salesman used to know the basic principle of "good faith." If everyone behaved perfectly morally, most legal costs and other expenses created by the implementation of rights would be done away with. Of course the problem of defining correct moral behavior and delimitation of individual rights would not be solved. The most extensive certainty of the law coming from moral behavior from individuals would stimulate many economic decisions, in particular investment decisions that would otherwise not be made due to insecurity about the behavior of others and the rights to investment profits. More productive forces would be developed and social product and welfare would increase. Morality as social capital makes decisions that are good for everyone possible, and thus increases the productivity of the company and national economy. For instance

[93] See Handelsblatt dated September 14th 2006, p. 9.

[94] See Handelsblatt dated January 26th 2006, p. 15.

researchers at the University of Bern in Switzerland found out that rats selflessly help even unknown members of their species if they had been helped in their own past. This allows us to assume that a willingness to help proved beneficial to evolutionary goals. The more help the rat had experienced, the more help it was willing to give.[95] Individual capital on the other hand is all of the prerequisites the individual has in order to produce added value, creating value without the community or third parties. Education as a goldsmith is an example of individual capital.

Each person has various abilities as a social being and individual. An efficient business organization seeks to combine these useful qualities through a structured assignment of function – through the inclusion of real capital, for example by bringing together machinery and patents – to create a greater synergistic whole and thereby the optimal creation of value. Human capital (through individual and social capital) and real capital create for the firm the maximum benefit, or greatest possible combined interaction of assets.[96]

Is social capital created without costs? Of course not. Just like for individual capital, it needs investments over longer time periods. Cooperation for networks must be practiced, for example. This means that every member practices their function in the network and learns who can give them what information or performance, and who to delegate to. Organizations, such as companies whose design and continuation create costs, are also social capital because they assign functions and structure a whole unit capable of making decisions and taking action, including practicing processes. Except for the costs of company excursions, the costs of social capital are not included in the controlling and national economy calculations. In fact, the labor time to create cooperative networks, in other words training cooperation, should also be measured and evaluated. Forgetting this fact, and because it is perhaps only difficult or quite costly to capture it in detail, a value estimate of this capital is neglected. Unfortunately the benefits reaped from the social capital are not attributed to social capital. In general only a small part of human capital is registered, with the corresponding distortions in the allocations of resources. With the costs to build up human capital, just the costs for education or training is registered, but even so, the value created or the individual and social capital do not appear as an asset. An employee who has been trained for a task in a company has human capital, be it more individual or social capital depending on the task envisioned. If the employee is incorporated into the company for this task, additional social capital is created. His "value" for the company is realized when applied for the good of the company, just like for a machine, and corresponds to the cash value of the added value from production minus the wage expenses and the expenses of the job. Human capital in positions filled is taken all too seldom into consideration, although the company is interested specifically in the optimal development of productive forces. Analyses of employee potential, in which the companies identify the maximum contribution an employee can make to value creation are thus invaluable in order to avoid poor resource allocation.

[95] See Weltkompakt dated July 3rd 2007, p. 25.

[96] See Conrad, Christian A. (2010).

The costs of the cooperative networks and a large part of the organizational costs for a company are recorded just as little as the company added value, which means that there is de facto no value approach. How can one explain the difference between the liquidation value of a company, thus the value of the net assets (value of the non human capital minus the liabilities) and the present value of the cash flow (or the shareholder value) as the net value creation of a company? Only through the added value that the organization, institutions and cooperative networks create via the productive combination of human and non-human capital. Alternatively formulated, if the cash value of the cash flow drops below the net asset value, it is often because of a poor combination of productive forces. The same applies of course in general for national economic systems as a whole and even for states. The state is also an organization, comparable to a company with branches with a systematic assignment of functions into a functional whole. Organizations, institutions and cooperative networks create added value in states as well, through the productive combination of human and non-human capital. Just like in companies, this added value is the difference between the value of a national economy's capital stock, or assets, and the cash value of the future GDP.

Improving productive forces is about the best possible assignment and structuring of organizations, institutions and cooperative networks. This is a science of order. Seen in this light it is possible to compare order using business science and economic science to find out what combinations of organizations, institutions and cooperative networks have had the best results or which deficits have been found. Human capital varies from country to country and is difficult to capture. This is a decisive factor to develop productive forces however, and therefore for the development of a country as well. These factors are more qualitative than they are quantitative. Despite the unpredictability, at least tendencies can be identified. An ideal order like a blueprint to guide companies or the national economy does not exist, and will never exist. The most that can be hoped for is the optimization of order as a framework for a company or economy and for a certain point in time.

The Incomputability is also the main reason for the previous neglect of qualitative factors. Despite this unpredictability however, there is not only an influence from these factors, this influence is so lasting that it would be negligence not to include it in calculations. Quantitative economic science does not explain why, for example, many Asian countries that were at a similar level of affluence to African countries were able to achieve economic prosperity in the last few centuries and many African countries have been fighting starvation despite development aid. The limited ability to predict and plan macroeconomic indicators is generally made clear by the different development in planned and market economic systems. The differences in the development between West and East Germany or North and South Korea after the war can only be explained qualitatively, thus by comparing the systems of order. On the other hand, Communism and Socialism were able to get many people to work until physically exhausted or to sacrifice themselves. Wages do not exist in these cases as an incentive, and the willingness to sacrifice oneself cannot be explained only through the threat of totalitarian measures of oppression. There must therefore have been an immaterial, intrinsic incentive. Why are there countries that develop into prosperous and dominant countries seemly out of nothing, increasing their capital stock many fold, just to then become meaningless and poor again without outside influence? Human capital is not a static factor. Also the institutions and organizations change.

Communism and Fascism are ideologies. Like religions, they give people clear moral values and behavioral guidelines. They give actions a purpose. Human behavior is given a value that goes above and beyond the material value, and it thus becomes a value in and of itself. Apparently many people want to believe in something good, something they can apply themselves to. They want to feel they are part of something bigger than themselves. One's personal benefit is at least partially subjugated to the greater good because individuals define benefit differently, and they feel better because of their activities for the group. Of course ideologies and religions are often abused and there tends to be a danger of being manipulated. We do not wish to preach an economic ideology, just to determine the importance of moral values as motivations for actions and behavior, and thus for the development of productive forces. Values as human capital can also advance societies as well as in particular companies and national economies by stimulating the productive forces of its people.

Humans aren't machines, and almost all of them question the sense in their existence either consciously or unconsciously. Considered in this way moral values are like the oil in the machinery, if we want to stick with the machine metaphore. If the values are lost, the engine grinds. The gears no longer catch for the functioning of the system as a whole, and take on a life of their own. People maximize their own benefit at the cost of the whole system. Such behavior was one reason of the Enron crisis and the subprime crisis. This is not the maximization of one's interests that encourages general welfare, as Adam Smith had in mind. The invisible hand cannot do anything against corruption and embezzlement. Profit and morality are not in conflict, as is often assumed. There can be no profit without morals, either in companies or national economies.

A survey of 400 German executives showed that the majority of problem-solving competencies are seen in self-organizing networks. Because of the collective intelligence, more creative impulses, higher innovative power, acceleration of processes and reduction of complexity can be expected by this organizational form than by others.[97]

Conversely, immoral behavior diminishes the added value of organizational forms. Let us assume that employees are distrustful and do not help each other anymore. If they do not exchange information among themselves or inform themselves wrongly, the added value they can reach through division of labor and cooperation will decrease.

Immoral behavior from top managers has the greatest negative effect on stakeholders and shareholders. The company's success is endangered by immoral behavior. Moral, ethical behavior is thus very important for companies, and the same applies among the companies and in competition. As we have already described, only fair competition for performance assures an optimal allocation of resources

[97] See Initiative Neue Qualität der Arbeit (2012), p. 7.

and thus an efficient economic production. Immoral behavior damages the society as a whole, beginning with market process, internal company processes and all the way down to interpersonal relationships.

The genetic disposition towards cooperative behavior we have already described is unfortunately insufficient. Hobbes had already recognized that cooperative behavior must be worth it for the individual, and that he must be able to trust in it, because otherwise we would have anarchy. How can this be achieved? Only if society encourages cooperative behavior by rewarding it and by sanctioning uncooperative behavior. Economic laws, courts and supervision are absolutely necessary for this reason. They have the task of acting as referee for behavior in accordance with competition, so they must be able to control competitive actions and sanction missteps. Without controls and sanctions there is no assurance of fair, thus economically ethical behavior. Cooperative behavior is the same as moral/ethical behavior. People will only trust the cooperative behavior of others if they can presume moral/ethical behavior, thus morality as a social standard to measure actions that must be practiced and trained (socialization).

The disparity described somewhat provocatively at the beginning between private, rewarded morality on the one hand and societal and politically unsanctioned immorality on the other hand is a basic evil that need not exist. The society must find appropriate conditions for moral behavior, which must be worth the effort in politics and economics. This is even true for a community of apes, where deceit, such as stealing bananas or beating weaker apes in the group is addressed and usually punished.[98]

Summary

Morality complements the positive effects of the market. The results of the market correspond only partially to our ideas of what is right. In case of market failure, morality ensures that third parties are not harmed. Against this background, the social market economy is entering the market and changing the distribution results. Social morality is an important corrective factor in the market economy. If a market economy is to be an advantage for society, society must discourage immoral, damaging behavior through legal penalties or social exclusion. In addition, it must promote voluntary ethical behavior through the provision of values.

In order for a society to function and to develop its productive forces, there is still the ethics of social capital which has to be in line with the orders, the system, and the economic stage of development. In this context, the attitudes of the people are particularly important for society, thus the community, and social cooperation. The norms, values and morality as well as the attitudes to the political and economic system are important.

Comprehension Questions

1. Define a company. What makes a company and what creates added value?
2. Define organization, institution, human and social capital.
3. To what extent is morality necessary for the functioning of an organization?

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[98] See Handelsblatt, dated 8th December 2005, p. 8.

5.7 The Company in the Market System

5.7.1 The Company's Objective of Maximizing Profits

Can the market process really regulate everything on the basis of human self-interest? Does the market really need any morality? Is it true that the companies earn more profit the less morally they behave? Do market laws allow any company to behave morally?

Roleplaying: Concealing of Negative Product Characteristics
Roles in the cigarette game: 1. Cigarette producer, 2. Supermarket salesman, 3. Sportsman with advertising contract, 4. Smoker and 5. Non-Smokers

According to Milton Friedman, there is only one company goal in the market economy, profit maximization:

> … and nature of a free economy. In such an economy, there is one and only one social responsibility of business – to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engage in open and free competition, without deception or fraud.[99]

Is this sufficient? The Ford Pinto scandal demonstrates the consequences of unilateral market profit maximization. Ford maximized the profit in the Ford Pinto by eliminating the inclusion of a plastic buffer at the petrol tank because the cost of $11 per vehicle was higher than the litigation costs and damage regulations from the fire incidents and the 180 deaths in accidents. In 1977, 9000 victims were killed in the previous 4 years in 20 million vehicles.[100] Market and morality are in contradiction here.

The goal of winning is the basis of a market economy system and as an incentive and sanction (loss) is the basis for the competition and thus for the productivity and prosperity of all. Without a profit there is also no investment in private ownership. No one profits from company losses, neither shareholder nor stakeholder. The profit is a residual income, that is, the amount remaining when the company has settled all period-related claims and obligations. Therefore, profit is ethically a good.[101]

Even in practice, many managers see profit and ethics as conflicting goals:

> I have great doubts as to whether one can always insist on the great moral imperatives. It is not an acceptable idea for everyone to have to carry an ethics handbook with them. The fake morality that we are a moral institution and that we should make profits accidentally disturbs me. This kind of illusion is not my world.[102]

A German chairman of the board said about the conflict of goals:

> Concerning the misconduct, I see is as actually only the tip of the iceberg. So I have to say, on the whole, I fear that in our leadership headquarters, I do not want to say an abyss of

[99] Friedman, Milton (1963), p. 133.

[100] See Wörz, M. (1994), p. 22.

[101] See Homann, Karl/Blome-Drees, Franz (1992), pp. 38.

[102] Quoted after Buß, Eugen (2009), p. 17. (translation by the author)

immorality, but in any case a great temptation every day to violate ethics and business ethics.[103]

There are different opinions about the moral responsibility of entrepreneurs in the objective of profitmaking. For Ulrich, the maximization of profit is socially legitimate, if it also serves other people, or society as a whole, thus increasing the prosperity or the satisfaction of everyone. The profit maximization becomes problematic if it conflicts with other societal objectives. If moral behavior leads to profit losses in the company, goods must be weighed. Economic ethics suggests that profit maximization is subject to a legitimacy reserve. It is legitimate if only non-priority goods are injured.[104]

Moral economics, on the other hand, frees businesses from responsibility. Homann and Drees attach the legitimacy of the profit goal to the existence of a legal and moral framework that ensures that all legitimate claims of stakeholders are taken into account. Economic actors must also comply with these rules without fail. Profit is socially legitimized by the framework in the form of the democratically adopted laws that do not damage the society or at least the damage has been compensated, leading to a welfare increase (including the environment, etc.).[105] Both authors go even further by seeing the responsibility for ethical corporate policy in the government. It has to create the morally correct incentives. If, for example, child labor is not prohibited, an entrepreneur must also use it because he would otherwise have a competitive disadvantage.[106] Economic ethics is thus a pure ordinance or institution ethics. Company rules must ensure moral behavior.

Even Kant saw the highest good in the connection of morality and (one's own) happiness.[107] Morals are worthwhile. Homann and Blome-Dress, however, go a step further. In the event of a conflict, they place the profit from goods over the ethical goods.[108] If this is only a matter of one's own happiness, it is in contradiction to Kant. For him, his own happiness must never be the chief determinant of action, one can only strive with morality and hope to see that there is no conflict to moral goals to which one must subordinate one's own happiness.[109]

We can maintain that there must be a legal framework that is moral, thus ensuring that all legitimate claims of stakeholders are taken into account. The emphasis on the necessity of a morally organized economic order is very important. However, such an optimal order, which is also universally adhered to, is a theoretical construct that can never be that complete in practice. A framework can never regulate all actions in all situations, nor is it always known to the actors, and finally the com-

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[103] Quoted after Buß, Eugen (2009), p. 17. (translation by the author)

[104] See Ulrich, Peter (2001), S. 415. "Legitimate profit-making is always morally limited profit-making." Ulrich, Peter (2001), p. 415. (translation by the author)

[105] See Homann, Karl/Blome-Drees, Franz (1992), pp. 39 and 51.

[106] See Homann, Karl (1999), p. 330 and Homann, Karl/Blome-Drees, Franz (1992), pp. 18 and 36.

[107] See Kant, Immanuel (1788), p. 238.

[108] See Homann, Karl/Blome-Drees, Franz (1992), p. 145.

[109] See Kant, Immanuel (1788), pp. 217, 243.

plete enforcement of such a framework is not possible. There will always be attempts to undermine the framework if there are short-term benefits to the company. The economic regulation cannot therefore issue a moral legitimation license. It is precisely at the international level that there is a conflict between legal profit making and ethics, thus socially legitimate behavior. Below there are a few historical examples listed. The maximization of profits must therefore be subject not only to a reservation of legality but also to a reservation of legitimacy. In the case of company policy, profit as a good must be weighed ethically with other goods. The profit goal cannot be pursued at the expense of the society, but must be used by the society.

Examples

1. VIOXX: US Merck conceals fatal side effects that have occurred in the clinical trials in order not to endanger the turnover from rheumatoid arthritis patients.[110]
2. Nestlé: Aggressive marketing of maternal milk substitutes in Africa led to death due to the use of contaminated water. Public outrage caused cessation of marketing.[111]
3. NIKE China's sports shoe manufacturing in so-called "sweatshops" paying a pittance led to public criticism, especially by non-governmental organizations (NGOs). Nike then created better working conditions in the supplier companies and accepted the losses in profits.[112]
4. Damage to the health of workers in the South American and African flower industry by the use of pesticides, with very low wages.[113]
5. Motorola renounced the sales market South America, because business could only be conducted with corruption.[114]
6. The US mechanical engineer Cummins renounced the sales market South Africa due to the former apartheid regime.[115]

In order to make the ethical consequences of the profit goal transparent, a qualitative controlling is required.

[110] See Frankfurter Allgemeine Sonntagszeitung, dated October 10th 2004, No. 41, p. 69. http://www.faz.net/aktuell/wirtschaft/unternehmen/vioxx-skandal-risiken-nebenwirkungen-1191252.html (5.05.2015).

[111] See Steinmann, Horst/Oppenrieder, Bernd (1985), S. 171and Spiegel, dated June 1th 1981. http://www.spiegel.de/spiegel/print/d-14336212.html

[112] See Scherer, Andreas Georg (2003), p. 12.

[113] See Göbel, Elisabeth (2010), p. 161.

[114] See Post, James/Preston, Lee E./Sachs, Sybille (2002), pp. 94.

[115] See Post, James/Preston, Lee E./Sachs, Sybille (2002), p. 106.

5.7.2 *Weaknesses in Controlling*

Meanwhile, conventional controlling is criticized for the fact that it only provides information on short-term monetary target achievement. Costs, profit and/or profitability ratios are quantitative and do not say anything about their ethical background. Ethically motivated actions generally lead to qualitative, long-term results. This kind of controlling thus creates a barrier for ethical behavior. Göbel asks why a manager should choose an alternative that will bring less profit in the short term, but in the long run a better reputation or a higher motivation of the employees.[116] Such tight controlling means that long-term consequences, risks, difficult-to-measure consequences and consequences that occur in other departments of the company are not obvious.[117] For this reason, a different focus on controlling has been required for years. In so-called strategic controlling, the long-term, qualitative and indirect consequences are also to be included.[118] The most ethical consequences of entrepreneurial activity are long-term and qualitative. A set of short-term quantitative targets can lead to these being achieved at the expense of ethics.[119]

In the meantime, there are some approaches that complement traditional controlling with ethically-oriented information. Companies can collect the services they have rendered for their employees or other stakeholders in so-called social balance sheets. They are divided into a social report, a value-added statement and a social account. For example, in the social report, company payments or further training measures are listed, the value-added statement shows the company's contribution to the national product and social benefits of the company to society in expenditures for charitable purposes, such as reforestation projects or the like. There are also specific environmental or life cycle assessments. For example, the quantity of waste and its disposal costs can be recorded in the production or, in general, all quantifiable burdens on the environment generated by the company.[120] Meanwhile, there are also so-called Corporate Social Performance (CSP) figures, which are levied for capital market investors looking for sustainable investments, where ecological, economic and social indicators are determined. The Global Reporting Initiative has developed a guide as a market standard for this type of sustainability reporting.[121]

The above steps do not resolve basic controlling problems, however. There are many effects of corporate activity that cannot be quantified and thus cannot be recorded. And why should a company that damages the environment be interested in documenting its activities? This would require state, thus institutional, guidelines

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[116] See Göbel, Elisabeth (2010), p. 259 and Hahn, Dietger (1997), p. 21.

[117] See Fridl, Birgit (2005), p. 288.

[118] See Eschenbach, Rolf (1997), pp. 102.

[119] See Conrad, Christian (2010), pp. 121.

[120] See Eisele, Wolfgang (2005), pp. 494; Seidel, Eberhard (1995), pp. 358, 367; Wagner, Gerd R. (1997), pp. 177 and Göbel, Elisabeth (2010), p. 281.

[121] See Bassen, Alexander/Senkl, Daniela (2010).

that would force companies to keep such balances. In order to avoid manipulations, external auditors would also need to review these balance sheets.

In addition, there are ambiguities that make it difficult to record information. For example, a low level of health care costs can be traced back to a good working climate as well as to high pressure and fear of redundancies.[122]

If measurement of the performance of individual employees is not possible in large corporations, commitment is often measured instead of performance. It can be useful for the employee to stay in the office longer, even if he is not doing any productive work, just to make a good impression with the superiors. These are also unethical incentives. It is worthwhile to make a show of diligence to the boss. Rewarding employees is thereby unfair and the time given by the employee has no advantage for the company.

5.7.3 Corporate Social Responsibility

The concept of social responsibility is currently often discussed as corporate social responsibility. According to Milton Friedman's Chicago School, a company has no social responsibility.[123] Is this really so? The majority of textbooks name profit maximization as the corporate objective. The shareholder value approach, however, has once again demonstrated how inaccurate profit is as a benchmark for economic performance and the company's success. Ultimately, despite all the textbook specifications, there are no natural company targets with a predetermined weighting. What is clear is that a company must earn more income in the long term than it has expenditures. Otherwise, there is a lot of room for differences in how much profit is to be earned, and what other goals a company wants to pursue. Extreme returns naturally limit the pursuit of other targets. Thus in the age of the industrial revolution some entrepreneurs have financed social institutions from their profits. These were exceptions, but it shows that it is possible to pursue other objectives besides profit maximization without negatively affecting the development of the company as long as the productive processes of the company are not impaired.

Social goals should not be misunderstood as inefficient employment of superfluous employees. It is important that the productive forces of the business process are used to ensure the highest possible added value, which can then be distributed. However, the question arises at what price and at whose cost profit is maximized. Profit can for instance be maximized at the expense of the environment and thus the public. What about employee layoffs? A company cannot oppose market laws because it would risk its existence in the medium term. The above-described

[122] See Göbel, Elisabeth (2010), pp. 284.

[123] " … and nature of a free economy. In such an economy, there is one and only one social responsibility of business – to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engage in open and free competition, without deception or fraud." Friedman, Milton (1963), p. 133.

functions of market and competition make this clear. If, for example, the demand for a product falls, or it is produced at a lower price elsewhere, the company can no longer employ its workers involved in production without operating at a loss. The employee's costs exceed his value-added contribution in the company.

Against the backdrop of continued technical progress and increasing globalization, mainly due to constantly improved communication and transport techniques, the international division of labor is subject to ever-changing conditions. This in turn leads to cheaper products for the consumer, but also to ever faster changing conditions on the supply and demand side for the companies. This means that the optimal use, the placement of people in the production process also changes more and more quickly.

The company has a responsibility to its employees, as well as the employee to the company. This is also called loyalty. Companies and employees depend on mutual cooperation. There is something like an implied loyalty contract. What a company can contract and control from its employees is far less than a motivated and loyal employee is able to give the company. If the employee is not loyal, he can cause damage to the company, such as the bribed buyer who buys bad and expensive intermediate inputs from a supplier for the company. If the loyalty between employees and companies is neglected it will have negative consequences for both sides. This dependency of the company on moral behavior from the employee is not the only side of the equation. He does not even have to deliberately damage the company for his own benefit, it is sufficient if he decreases his work performance for the company imperceptibly. There is a big difference between commitment to one's job and meeting the minimum expectations.

Employees slowing down their pace of work does not help the company, especially in the era of increased competition in globalization. Perhaps the employees are also pursuing second jobs or hobbies during their working hours (consumption on the job). In the age of lean management, what company can afford to control all employees all the time?

Moral behavior is important for every company. Immoral behavior reduces economic efficiency. Morally, this means that the employees behave to the benefit of the company. The fact that employees are expected to behave loyally is a established understanding, which, has seemingly been forgotten in the light of unscrupulous manager enrichment in recent corporate crises.

A company is dependent on its employees to represent the interests of the company above their own interests, at least during their working hours. Employees must devote themselves fully to corporate productivity and also be loyal. Disloyal employees can damage the company permanently. Oftentimes the company's employees have knowledge about the company's competitive secrets and valuable company inventories. Employees are also generally expected to behave morally towards their colleagues. Only if the employees are open and fair among themselves is cooperation and thus common added value possible. If employees do not behave morally, superiors can no longer rely on their information or their performance. If employees manipulate their coworkers or hinder the success of other employees, as in the Enron case, management can no longer make optimal use of their employees.

Conversely, a permanent workplace is not only the prerequisite for the employee's livelihood, but usually also for his family. Suppose the employee was loyal and his value-added contribution to the company was much greater than the salary he received over decades. Then, according to the implied loyalty contract, the employee would expect the company to be loyal as well. Kant saw a connection of gratitude for services as part of what separates humans from animals.[124]

A company must therefore weigh the social burden redundancies can cause and should make every attempt to promote the employees within the company. If the company does not take the employees' interests to heart, it will deter potential employees. The company would risk the loyalty contract, thus the loyalty of all employees.

However, the burdens caused by structural changes resulting from globalization should be borne primarily by the public, thus the state. The general public benefits from the advantages of national and international market and competition mechanisms. The resulting welfare gains can be used to mitigate the negative effects of the market process. Social cushioning, in turn, increases the acceptance of market processes and the flexibility of workers who are not afraid of losing their jobs. In addition, the social security network keeps human capital from deteriorating and available for the work process. This is an advantage of the social market economy (see the chapter before).

The environment of a company considers it to be a part of the community. It lives not only in the community, but from the community, creating mutual dependency. The community is not only the income side either, since the employees are the most important input factor. The legal framework is also determined by the community. Even companies with the initial protection of politicians would not be able to maintain a position of defiance. BP could not stand up to the pressure from the public when the oil platform Brent Spar sank, because it is dependent on the community. This still holds in the age of globalization, though the community must be defined more broadly, or more internationally. According to the principle "do ut des" a minimum of social responsibility must be demanded from the company, which would explain the critical opinion of a large part of the population towards company abuse of the rules. The managers representing company decisions see themselves confronted with these expectations. The term 'social' here has nothing to do with socialist, but means a responsibility to the community. We cannot presume that companies have a conscience for social behavior; it must be demanded publicly by the community in the form of laws. If this does not occur, the company does not have a monetary incentive to behave as the community wishes and can in fact maximize its profit at the cost of the community (e.g. by disposing of production waste in a harmful manner, unfair competition or manipulating balance sheets). The behavior in accordance with the demands of the community may display cultural differences. We must be aware however that with technical progress (Internet,

[124] See Kant, Immanuel (1797), A108 and Kant, Immanuel (1793).

satellite television etc.) the economy is not the only thing being globalized, but that values, social movements and tendencies have shifted. The boycott of companies who had supported apartheid was carried out globally, for example. The increasing importance of public relations is also clear in the number of international firms that have begun publishing social and environmental reports.

The responsibility of companies towards society was already being debated more than a hundred years ago.[125] An example of a public interest is a clean environment. An NGO representing this interest is Greenpeace. These groups place moral demands on companies and try to exert influence on companies through public discussion in the media. The media here has a special social significance and responsibility as a catalyst for public interests.

Role-Play Game: Concealing Negative Product Properties
Choose the roles you want to play and discuss the roles of the various positions.

Cigarettes: 1. smokers (x2), non-smokers (x2) and tobacco companies (x2).

or

Energy drinks: 1. producer, 2. supermarket salesman, 3. sportsman with advertising contract, 4. consumer and 5. advertising agency.

Case Study: The Disaster of BP's Deepwater Horizon
Circumstances of the accident

Eleven people died in the explosion of the drilling vessel Deepwater Horizon on April 20 2010. The outflowing oil has led to a massive environmental disaster. Approximately 5000–100,000 barrels of oil into the Gulf of Mexico on a daily basis and the borehole could not be closed for months. According to a US court 3,19 million barrels (159 l each) of oil ran into the sea.

Public Relations

He wanted his life back. The BP disaster of the Deepwater Horizon was the largest oil spill in the world and the worst environmental disaster in US history. BP management tried from the beginning to downplay the disaster. For instance the chief executive of BP Hayward said that the spill won't cause big problems because the Gulf "is a very big ocean" and "the environmental impact of this disaster is likely to have been very, very modest." Hayward was speaking at an oil-spoiled beach in Louisiana on May 30th right into a TV-camera: "There's no one who wants this thing over more than I do, I'd like my life back." Hayward said on May 31st that there is "no evidence" that huge amounts of oil are suspended undersea.

Accusations

The BP rig was located in 1500 m deep water and had a drill reaching 5500 m deep into the ground. The MEPs from the Energy Committee have repeatedly criticized BP for breaching the usual safety standards. MEPs Henry Waxman and Bart Stupak came to the conclusion in 2010 that, "BP repeatedly chose risky procedures

[125] See Heald, Morrell (1957).

in order to reduce costs and save time and made minimal efforts to contain the added risk... Time after time, it appears that BP made decisions that increased the risk of a blowout to save the company time or expense. If this is what happened, BP's carelessness and complacency have inflicted a heavy toll on the Gulf, its inhabitants, and the workers on the rig."

BP was under pressure, as the work on the drill hole in the Macondo field was 6 weeks behind schedule. Each day's delay cost BP at least half a million dollars. BP responded with savings. For example, internal BP studies had recommended a double-walled lining of the drill hole with steel pipes. Nevertheless, BP decided to install a simple steel pipe at the end of the drill hole, saving the company seven to ten million dollars and 3 days' work.

The heavy drilling mud in the hole was meant to keep the oil in the deposit. According to the guidelines of the American Petroleum Institute, drilling mud has to be circumnavigated once to inspect it for enclosed gas bubbles and rock fragments. BP refused to do this.

The steel pipe of the liner must be surrounded by a concrete mantle in the larger well. This prevents gas escaping uncontrolled from the source. Spacers are used to hang the pipe centrally in the shaft. On April 16, BP decided to install only six of these "Centralizers", although a manager from Halliburton, recommended 21 centralizers and warned otherwise of a "serious gas flow problem." BP decided to save the time by flying in the remaining 15 spacers from the mainland. BP canceled the proposed test of the concrete layer. So BP was able to send the experts back who were already on board the Deepwater Horizon on April 20, and thus save a net 118,000 dollars for the up to 12 h-long test. Finally, at the top of the borehole, BP did not secure the wellhead with a lockdown sleeve before allowing pressure on the seal from below.

MEPs came to the conclusion that BP neglected four out of six barriers against rising gas, while two of the four were probably not functioning.

There were other failures. A BP manager decided shortly before the accident to exchange the drilling mud for seawater in the production pipe between the seabed and the surface. There was a loud controversy between the BP representative and a person from the company Transocean, which operated the Deepwater Horizon. Because of its lesser mass, water can exert less pressure on the source than sludge so that the gas is more able to ascend. A warning device and a device to stop the gas supply were missing in the engine room of the drilling vessel. In the end there was a gas explosion.

Consequences

BP estimated in July 2016 that the costs from the explosion of the oil platform Deepwater Horizon totalled nearly 62 billion US dollars in penalties, damages, cleaning expenses and court costs. After including tax deductions it came to 44 billion dollars. However, BP's annual profit in 2014 was already as high as before the disaster at 25 billion dollars.

Hayward had to step down from his position as CEO. He received $1.5 million in compensation and a pension of $17 million from BP. In 2011 Hayward returned to the oil business. Together with investors and the Turkish billionaire Mehmet Sepil, he founded the company Genel Energy to explore oil in the Kurdish north of Iraq. Mehmet Sepil was punished in 2010 in the UK for insider trading.

Hayward still has a good reputation in the oil industry. "People know he was the scapegoat, he was the sacrificial lamb," said Fadel Gheit, an oil and gas analyst at Oppenheimer & Co. In 2013 Tony Hayward was awarded the honorary degree of Doctor of Technology by Robert Gordon University, Aberdeen. While standing loyal at the side of Hayward during the scandal, his wife Maureen Fulton was granted a 'quickie' divorce in 2012, saying Hayward exhibited 'unreasonable behaviour.'

Tasks
1. Apply the ethical evaluation criteria known to you.
2. What is the blame for the BP disaster and how would you have judged it?
3. How do you explain the behavior of BP?
4. Has the behavior of the management paid off?

Solution of Task 1
1. Conviction ethics: The security requirements were deliberately not adhered to by BP, which is why one cannot assume a moral attitude, that is, no good will. In addition, the BP management did not show enough compassion and regret after the oil disaster, as judged by the public.
2. Kant's rules of ethical reasoning: (A) Categorical imperative: Law: Everyone violates the security requirements: No! Would I myself be willing to be affected by such risky behaviour? No!

   (B) Publicity rule: The rights of the public and BP workers have been violated: No! (C) Practical Imperative: No, BP only used the environment as a means to maximize profit.
3. Duty ethics (deontological ethics): No, the security requirements were clear.
4. Ethics of responsibility (teleological ethics): The security requirements served the purpose of preventing such a misfortune. BP has seen the consequences of negligence.
5. Moral Economics: There appeared to be insufficient state controls revealing and punishing the negligent behavior of the oil companies in drilling, so everyone is forced to behave in a risky manner.

http://thehill.com/blogs/congress-blog/energy-a-environment/103255-letter-to-tony-hayward-chief-executive-officer-of-bp-rep-henry-waxman-and-rep-bart-stupak; http://www.alternet.org/rss/breaking_news/209848/waxman_letter_to_hayward%3A_bp_%27carelessness_and_complacency_have_inflicted_a_heavy_toll%27; https://www.welt.de/wissenschaft/article139533067/Die-lange-Katastrophe-der-Deepwater-Horizon.html, http://www.handelsblatt.com/unternehmen/industrie/deepwater-horizon-umweltskandal-kostet-bp-62-milliarden-dollar/13880076.html, http://www.sueddeutsche.de/panorama/golf-von-mexiko-oel-katastrophe-sparen-und-sterben-1.959866; http://www.spiegel.de/wirtschaft/unternehmen/deepwater-horizon-ex-chef-von-bp-tony-hayward-ist-zurueck-a-1002134.html; https://www.thetimes.co.uk/

article/embattled-bp-chief-i-want-my-life-back-jmnmvng9p0s; http://ireport.cnn.com/docs/DOC-461890; http://content.usatoday.com/communities/greenhouse/post/2010/05/scientists-warn-of-oil-plumes-under-gulf-surface/1#.WSQQv2e7qig; http://www.nzherald.co.nz/business/news/article.cfm?c_id=3&objectid=10748826; http://www.rgu.ac.uk/news/robert-gordon-university-honours-oil-executive/; http://www.dailymail.co.uk/news/article-2241697/Divorce-shamed-BP-chief-Tony-Hayward-loyal-wife-stood-wake-Deepwater-Horizon-disaster.html#ixzz4htphzxOp

Is there a conflict between morality and profit? There are empirical studies that show that socially responsible companies are equally successful or more successful than others.[126] However, the costs of ethical measures tend to be short-term, while the gains are only in the long term. For example, short-term costs arise from no longer using child labor in Asia, and only in the long term is the profit derived from a better image. In the short term, the renouncement of safety measures for deep-sea drilling (BP) is unlikely to lead to losses from oil leaks and environmental damage, but to high profits. In addition, the benefits that ethical business policies entail are often qualitative (intangible assets, soft facts) that are not measurable (such as employee loyalty and satisfaction, image and trust).

According to an Emnid survey, a stronger consideration of family aspects led to an increase in satisfaction and motivation among 85% of employees.[127] According to a Prognos study, family-friendly measures show a return of at least 25%.[128] Some of the costs of immoral trade are illustrated by examples. For example, Paine estimates Roebuck & Company's loss due to immoral selling practices at $60 million.[129] Gallup, the consulting firm, was able to show that the productivity of companies can be improved by increasing their emotional employee loyalty.[130]

The German University of Economics and Management surveyed 1000 interviewees and found that motivation barriers account for an average loss of 29.9% in labor productivity. This is a great potential for increasing the productivity of companies in Germany.[131]

In another study, with 1000 employees surveyed, asked which is the most important of three factors for their productivity; 59% of those questioned answered employee satisfaction, followed by payment (including company profits), and 42%

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[126] See Donaldson, Thomas/Preston, Lee E. (1995), S.71; Margolis, Joshua Daniel/Walsh, James Patrick (2001) and Bassen, Alexander/Meyer, Katrin/Schlange, Joachim (2007).

[127] See Becker, S. (2003), p. 33.

[128] See Prognos AG (2003).

[129] It was determined in the lawsuit against the auto service company Sears, Roebuck & Company that the extreme incentives to increase profits led to an increase in cases of customer fraud. There were minimum work hours for mechanics and minimum sales requirements for certain auto parts as well as large rewards for high profits, all of which put employees under too much pressure. See Paine, Lynn Sharp (1994), pp. 107.

[130] See http://www.gallup.com/de-de/175571/gallup-gmbh.aspx and http://www.schmezer-consulting.de/news-detail/items/erfolgsfaktor-mitarbeiter-fuehrungskraefteentwicklung-gallup-studie-2014.html

[131] See Büser, Tobias/Stein, Holger/von Königsmarck, Imke (2012), p. 3.

named the company's working climate and a good relationship with colleagues.[132] Studies show that hostility in the workplace promotes mental illness. Fear and depression due to lack of recognition reduce performance and productivity. Respect and recognition are the basic prerequisites for identification and motivation. Collegiality in the office prevents depressive moods and boosts performance.[133]

Summary
Ethics pays off in the long term for companies. There is a short-term goal conflict between profit and ethics but not a long-term one. Central to the functioning of a market economy on the basis of self interests is private property. Otherwise, the incentive and sanction mechanisms of the competition functions described above do not work.

Comprehension Questions
1. Do companies have a social responsibility?
2. To what extent does market take morality into account? Explain this using the allocation model and the competition functions.
3. Is there a target conflict between profit and morality?
4. To what extent does morality complement the market?

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[132] See Institute of Leadership & Management (2014), p. 2.

[133] See Volk, Hartmut (2006).

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Chapter 6
Institutional Ethics: The State Regulatory Framework

What Follows Why?
Institutional ethics must provide a framework that enforces moral behavior in business. In the following, we will examine the Prisoner's Dilemma as the fundamental problem of institutional ethics, and introduce the codes of ethics that should enforce ethical behavior in business practice.

Learning Goals
You should be able to explain the national and international Prisoner's Dilemma and to present approaches to overcoming these dilemmas.

6.1 The Ethical Prisoner Dilemma

If all competitors behave morally it creates a fair performance competition from which all parties profit. It has already been established that the economic order has to exhibit moral behavior. If it is advantageous for a company to behave immorally, it may be forced to do so in order to remain competitive. Market advantages can result from unfair competition such as deceptive advertising, libel, etc. At the very least the trust of the consumer in the product is lost. Due to intransparency he will not buy the product from any company. This is a prisoner's dilemma.[1] Even if the company were to behave morally, it does not know how the other companies will behave, and therefore must assume immoral behavior and behave immorally in order to ensure its survival. There is a risk of an unfair predatory competition by means of concealed immoral means. The economic welfare potential cannot be achieved. The problem of ethical imprisonment always arises when no moral rules are enforced. The ethical prisoner dilemma is not just true for companies in competition but also for companies with unethical business cultures and for the employees

[1] See Kirchgässner, Gebhard (1991), pp. 51.

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Fig. 6.1 Payment matrix of fair competition in the ethical prisoner dilemma ***Nash equilibrium is the worst case for all (Nash: No one can unilaterally improve through another strategy)**

payment	B behaves morally	B behaves im-morally
A behaves morally	(5, 5)	0, 6
A behaves im-morally	6, 0	1, 1*

themselves. This also applies to the internal competition of employees within the company. Here an employee can gain a career advantage by lying, as has already been shown in the case study "colleagues" (Sect. 2.1.3). Unethical companies cannot realize the collective best case with high productivity if the employees do not behave morally. Like with Enron, the employees compete internally and do not cooperate. The return of teamwork cannot be realized.

The ethical prisoner dilemma for a fair competition is as follows: The worst case for a company manager A is if he behaves morally, but the company manager of another company B does not and the best case for A is if A behaves immorally, but B does not. B is in the same decision-making situation. The result is the combination in which both companies operate unfairly, thus the worst case for all (Nash equilibrium). Without ethical rules, such as law enforcement when the ethical prisoner dilemma arises, a company finds itself in the worst-case situation if it behaves ethically (Fig. 6.1).

In the context of such a distorted situation, companies have the opportunity to approach the government and request a change to the regulatory framework. Unfortunately, such attempts to change regulations are rarely successful. Rather, many companies try to delay ethically motivated regulations for as long as possible. For example, Ford's self-defeating lobbying delayed Ford's security measures for 8 years to avoid the additional $11 of the plastic buffer on the petrol tank. Accident victims were accepted as a liability.[2] The egg industry, which defends the agonizing mass management of laying hens, is another good example.[3] This is due to the fact that the decision-making structure for A and B changes as a result of the company having to bear only a part of the costs of a decision in the case of decisions made at

[2] See Wörz, M. (1994), p. 22.

[3] See Göbel, Elisabeth (2010), p. 183.

Fig. 6.2 Payout matrix; decisions on third parties in the ethical prisoner dilemma
***Nash equilibrium is equivalent to the worst case for all. The morphological/moral combination is pareto-efficient**

payment A/B/third parties	B behaves morally	B behaves immorally
A behaves morally	[1, 1, (0)] **	0, 5
A behaves immorally	5, 0	[3, 3 (-10)] *

the expense of third parties (external effects, see Sect. 5.5.4). The payouts for third parties are therefore listed separately in Fig. 6.2. In the case of the environment, the cost of pollution is borne by the public, whose health and quality of life are adversely affected (negative external effects). In the case of work safety, the company can save costs at the expense of employees. In our examples above, the health risk affected Ford's customers or laying hens.

An empirical study has shown that managers are only willing to stick to moral standards when they believe their business partners are sticking to them. If this is not so, they are not willing to behave morally, even if they consider the rules to be important and meaningful.[4] In the case of the prisoner's dilemma, there is uncertainty about the conduct of the other companies. Even if they all wanted to behave ethically, they could not, because there was then the risk of coming into the worst-case situation. The solution to this problem is:

1. Clarification of A and B on the value of moral behavior, thus increasing the incentive to behave morally.
2. Moral behavior is rewarded by incentives (morality must be worth practicing). An ethical consumer awareness leads to increased sales of ethical products.
3. Binding contracts with sanctions: laws, state control and sanctions in cases of misconduct (ethical order policy).

6.2 Ethical Institutions and Organizations

The significance of an ethical framework has often been discussed. Without an ethical rule, thus laws which are also enforced, an ethical problem arises in which the company comes into the worst-case situation, which is unethical. Of course,

[4] See Blickle, Gerhard (1996), p. 116.

positive incentives such as environmental subsidies can also help escape the ethical prisoner dilemma. After all, the state can counteract unethical behavior by trying to develop social morality and thus shape employees either before they enter the company or create a more ethical environment for the company. Ultimately, all citizens are asked to act ethically in their environment (duty ethics).

Institutions have evolved over time to overcome social dilemma structures, such as the state legal system. Institutions are made up of people who serve people. They regulate interpersonal coexistence, in which they place appropriate incentives, for example laws and penal sanctions in the event of an offense. Ethics, which is concerned with moral institutions, is called institutional ethics, social ethics, or even order ethics.[5]

Insofar as we are not dealing with a dictatorship, institutional ethics derives from collective ethics. All social regulations are developed and implemented by the community. An institution such as the legal system must be morally recognized by society. It is only through compulsion and control that institutions cannot go against the will of the individual. The institutions also shape the individuals who live with them. Together with non-legislative collective ethics (norms) and parents, institutions determine the socialization of individuals. Ultimately, the institutions, such as the legal system, determine the consequences of moral actions and thereby set the incentives to behave in certain ways. If there is no employment law and a prohibition of association, the employee is not only at the mercy of the employer (institutional ethics), but another employer is also hard-pressed to make concessions to his employees as he has to fear competitive disadvantages. Moral behavior is thereby made more difficult. Institutions such as democracy, with all the legal regulations on the division of powers, make it possible to exercise equitable, and thus moral, discourse ethics.

In a study that investigated why people obey laws, it turned out to be crucial for most people that they are convinced that the laws are ethical and legitimate. Furthermore, most people feel a strong commitment to follow laws that address education and protect the environment. Penalties are necessary for a minority, excessive penalties in case of violation of regulations can have a counterproductive effect.[6]

Social moral norms and values emerge in a trial and error process: a cultural evolution. They express what behavior is desired by society because it benefits society and its members. This behavior that a company considers positive is rewarded by social recognition. Conversely, negative and thus societally damaging, behavior is sanctioned by social exclusion or even by the judiciary as a social organization. We refer to people as good when they are positive for others and vice versa. Ultimately, the categorical imperative of Kant expresses exactly this: always act so that your action could be the basis of a general law, or as per the saying “what you do not want done to yourself, do not do to others.” Ultimately, laws are valid for

[5] See Göbel, Elisabeth (2010), p. 34.

[6] See Tyler, Tom E. (1990) and Paine, Lynn Sharp (1994), p. 111.

everyone and represent a social rule that should be valid for all. Equality before the law should always apply.[7]

Legitimacy derives from what reason, conscience, and public discourse recognize as justifiable interests. Legitimacy does not necessarily follow legality. Laws can also be immoral, such as the laws on racial segregation in the US and South Africa. Economic activities can be legal but unethical, such as child labor in some countries. Finally, many unethical practices are not punishable, because a court action is often not worthwhile or the injured parties lack the necessary financial resources.

An example of the difference between legality and legitimacy from the company's point of view is the case of the 1991 Salomon Brothers. Four top managers were reported for legally non-conformist behavior at the trading table for government bonds. They had their legal department check whether they were obliged to publish the lapse, and they were not. However later, when the incident came to the public, their silence led to a massive breach of trust that led to an estimated loss of one billion US dollars due to customer or contract losses and higher legal and refinancing costs.[8]

The state regulates the company's dealings with its stakeholders through laws and regulations. Of particular importance are the following:

(A) Employee protection rights
(B) Protection of consumers (starting with the general terms and conditions of business, the regulation of prices, the food regulation and the Unfair Competition Law).
(C) Investor protection (from the Investment Protection Act to the Securities Trading Act)
(D) Environmental protection legislation (covers waste disposal, noise protection, air pollution, water protection and landscape protection)
(E) Animal welfare laws and regulations

6.3 Is the State of Law Sufficient?

The economy produces goods for the community to consume and invest in. This is necessary for the survival of the community, but there are also other products that the community needs. These include inner stability, including internal security, low crime rates, a general harmony amongst its members and thus a smooth functioning of societal and economic processes. There are many prerequisites for this to happen, including societal rules and laws and thus institutions and organizations to implement them. These alone are not sufficient, however. Social morality, good behavior and politeness are additional prerequisites for societal processes to run smoothly.

[7] See also Habermas, Jürgen (1975), p. 72
[8] See Paine, Lynn Sharp (1994), p. 110.

The state as an organization cannot control, monitor and implement everything. Even if one were to attempt to do so, the expense would be enormous. On the other hand, if social rules were not adhered to by anyone the social system would collapse. Machiavelli had already realized this in his Discorsi: “Just as… laws are necessary to maintain manners, good morals are necessary to respect the laws.”[9] This interconnection also applies to the economy, since the economy is part of the society, but we will address this in more detail later on. Good manners, morality or more generally, behavior in conformance with the community, is mostly transmitted through social education. This basis for behavior is another good needed for the society to survive, and which must be produced by the people themselves. It is not just a question of rules and control. For instance, you cannot make a functioning company out of a prison full of criminals. Even if the criminals are controlled as well as possible, the outcome will be miserable without motivation and morality.

Market failure would occur without these laws. For example, some companies in Germany use the fact that the packaging sizes are no longer regulated by law. Price increases are hidden by a smaller packaging content. The consumer only sees that the packaging costs the same as before. Such packaging tricks are unethical because they change the exchange to the disadvantage of the customer, without informing them about what is actually fraud in the broader sense.[10]

Laws are a necessary prerequisite for the functioning of an economic and social system but not sufficient. Without morality it does not work. Laws can be ignored because either control is incomplete or the punishment is not dissuasive. Thus, it becomes worthwhile for long-haul drivers not to comply with legally prescribed rest periods and to accept a fine. And in the construction industry the legal minimum wages are undermined. Laws can be circumvented. Since children’s programs are not allowed to show advertising blocks, the channels broadcast the programs as a “family program.” Laws are inaccurate or leave a great deal of room for interpretation because they must be universal and cannot anticipate every individual case. For example, there are interpretable terms such as “faithfulness and faith,” “carefulness,” or “reasonable compensation.” The Act on the Appropriateness of the Management Board Remuneration (VorstAG) merely states that the remuneration of the Management Board should be proportionate to the tasks and performance of the Management Board, the Company’s position and the usual remuneration.

There is, for example, a problem of law enforcement in the economy. Economic deprivation is seldom uncovered in comparison with other illegal acts, and even more rarely punished. In relation to the consequences and the likelihood of being discovered, the penalties for economic crime are far too small. For a long time economic science has been calling for a tightening of economic criminal law. For example, the economist Gary S. Becker claims that the penalties are based on the consequential damages and the probability of discovery. The aim is that the expected value of the sentence is not less than the consequential damages for society. For

[9] Machiavelli, Nicola (1977), p. 64.

[10] See Göbel, Elisabeth (2010), pp. 287.

example, if the impact of an action is €1 million and the probability of detection is 10%, the penalty would be €10 million.[11]

In order to comply with these laws, the acting norms and customs also need their own morality. Furthermore, society, economy and technology are developing, so that laws have yet to be enacted for many immoral acts. An example is the Internet and the mobile phone sector with new possibilities to take advantage of customers. Laws usually end at the borders of a country, which is why regulatory arbitrage occurs. By way of example, shipping companies bypass the safety regulations of their home countries by sailing under the flag of a country without regulations.[12] In general, morality or ethical awareness is the prerequisite for the emergence of laws and jurisprudence. In the case of legislation, the judge is bound to his conscience, as is the judge in case law. There can be no laws and no jurisprudence without morality.

You can also see it reversed. It is not the order that matters, but what people make of it. Here Johann Heinrich Pestalozzi can be cited as a representative of the people who believe that people can be influenced by education: "He has learned that all forms of government are of no use when people are no good".[13]

Summary

The economy produces consumer goods and capital goods for society. This is vital for society, but there are also other products that society needs. This is above all inner stability, which is to be understood not only as internal security, but above all a low crime rate, in general the harmonization of the citizens and thus the smooth running of social (also economic) processes. For this, there are many prerequisites: above all, social rules, laws and institutions, and the organizations to enforce them, but these prerequisites are not enough. Social morality, good manners or courtesy are further prerequisites for the smooth running of social processes. The institutions and organizations cannot control, monitor and enforce everything. If, on the other hand, no social rules were respected by anyone, the social system would collapse immediately. Where laws and control cease, morality begins. Morality regulates human behavior so as to prevent social harm.

Comprehension Questions

1. Explain the ethical prisoner's dilemma in fair competition and at the expense of third parties. What are the possible solutions?
2. Why is there a difference between legality and legitimacy?
3. Explain the extent to which morality is necessary for the functioning of a legal system.

[11] See Becker, Gary S./Becker, Guity Nashat (1998), pp. 173.

[12] See Göbel, Elisabeth (2010), pp. 289.

[13] http://haus-des-verstehens.ch/tagebuch-blog/636-johann-heinrich-pestalozzi-und-rosa-luxemburg.html

6.4 International Business Ethics

Role-Play Game: Globalization

Manufacture of clothing (or sports shoes) in India or China (child labor, occupational safety regulations).

In the discussion, take the following roles: 1. working child, 2. parents, 3. consumer, 4. foreign producer, 5. national producer, 6. national unemployed. Represent the interests of your roles.

1. Try to use the ethical assessment approaches already presented in chapter
2. Try to use discourse ethics here. After the discussion in the plenum, the audience will try to find an ethical solution to the globalization problem.

Explanation

The game takes only 10 min. There is no role description, because the participants should develop the situation creatively. They should identify with the roles. Here, the lecturer is given the task of probing and provoking a little bit. In the end, whole group is discussing including the audience. The following question should also be discussed: Is there an international economic ethic in the sense of the same ethical ideas?

Numerous ethical violations emerge from the discussion, but no solution can be found. There will not be western labor protection laws in China any time soon, so the competition is unfair. Due to ethical restrictions, western companies have higher costs. If the state does not compensate for these competitive disadvantages by means of tariffs or subsidies, they can only be compensated for by a lower wage or higher productivity.[14]

It is clear that in global competition we need a global legal framework that ensures ethical management. However, this is not to be expected in the foreseeable future. There is no supranational state organization, which causes uncertainty about the behavior of others and we again have a moral prisoner's dilemma. How can one get out of the international prisoner's dilemma?

The following solutions are offered, which are presented in more detail below:

1. Transparency and sanctions
2. International quality seal
3. Incentives
4. International Code of Ethics

[14] See Göbel, Elisabeth (2010), p. 182 and Bitzer, Tina/Elsen, Dominik/Illner, Elena/Müller, Michael (2015), pp. 280.

Non-Governmental Organizations (NGOs) are for example:

Topic:	NGO
Environment	Greenpeace
Human Rights	Amnesty International
Anti-corruption	Transparency International
Health	World Health Organization (WHO)
Healthy Food	Food Watch, Food and Agriculture Organization
Fair Trade with the Third World	European Fair Trade Organization

Fig. 6.3 Important Non-Governmental Organizations

6.4.1 Non-Governmental Organizations or Civil Society Groups

Non-Governmental Organizations (NGOs) are already trying to establish ethics on the international level through appeals to the public. They do not have direct sanction possibilities, but are dependent on the reactions of the public to control the misconduct of groups, for instance by a purchasing boycott.

One possibility would be that an international arbitration system compensates for competition violations through sanctions, as is the basic concept of the General Agreement on Tariffs and Trade (GATT). The non-governmental organizations could be given the function of an international prosecutor. They would follow evidence from competitors or act independently when the suspicion of unethical competition practices is suspected. They would take their complaint before the World Trade Organization on the basis of international agreements to be drawn up for this purpose. The WTO could examine the accusations and, in the case of ethical violations, allow counter-measures to the national states, such as countervailing duties (Fig. 6.3).

6.4.2 International Quality Seals

The moral prisoner's dilemma can be solved if morality is worthwhile. Fairness seals help to offset the distortions of competition as long as the consumers allow themselves to be guided by them. The certification of the Flower Label Program (FLP) label had the purpose of implementing ethical working conditions in the production of cut flowers and was based on the International Code of Conduct (ICC) for cut flower production. It had to be abandoned because of the lack of financial resources. It was no longer possible to carry out an inspection of the measures. The ICC was developed and published in 1998 by the non-governmental organizations, trade unions, producers and trade. The Code of Conduct provides ethical working, social and environmental criteria. The basis for this are the UN human rights instruments, the relevant conventions of the International Labor Organization (ILO) and environmental standards. For 20,000 workers in cut-flower plantations in Africa, Asia and Latin America, FlowerLabel Program had achieved fixed employment contracts, maternity protection, occupational health and safety. Among other things, pesticides prohibited in Europe were prevented from being used in non-regulated developing countries.[15]

Fairness seals can also be issued by Civil Society Groups. For example, Fairtrade or TransFair seals for goods, e.g. coffee imported at a fair price, or Rugmark for carpets produced without child labor. Ecological companies developed the Demeter logo for organic food.[16] It is important for such quality seals to be credible through neutral institutions such as NGOs.

The Clean Clothes Campain (CCC) works to achieve better working conditions in the production of clothing in countries where labor is cheap. The "Code of Labour Practices for the Apparel Industry Including Sportswear" is based on the ILO. Companies are called upon to mandate compliance companies to monitor compliance with the Code. The CCC is a network in which 22 nationwide working organizations, or associations have joined together to form an organization. The campaigns of the organization show that many companies do not meet the requirements.[17]

6.4.3 Incentives to Overcome the International Prisoner's Dilemma

An ethical awareness among consumers or investors causes an ethical behavior of the companies through the market. Ethical management is rewarded. In the meantime, there are many incentives for companies to ethically standardize their corporate policies. For example, there were 174 investment funds in Germany in 2008, which only invested according to specific ethical criteria, such as no arms business, no child labor or forced labor, ecologically sustainable business, and promotion of renewable energies.[18] The funds are supported in their investment policy by specialized research and rating agencies. Violations are registered to create a negative selection. In addition, the companies are assessed according to ethical criteria and ranked in order from which the investment preferences can then be derived. Possible

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[15] See Weißmann, Norbert (2000), p. 123 and http://www.fian.de/online/index.php?option=com_content&view=article&id=407:blumenguetesiegel-flower-label-program-flp-vor-dem-aus&catid=56:pressemitteilungen&Itemid=59

[16] See Göbel, Elisabeth (2010), p. 182 and 184.

[17] See http://www.cleanclothes.org/resources/ccc/corporate-accountability/the-ccc-model-code and http://www.cleanclothes.org and http://www.saubere-kleidung.de/index.php/wer-wir-sind/25-wir/28-die-traegerorganisationen

[18] See Göbel, Elisabeth (2010), p. 315.

aggregate endnotes or individual company-specific evaluations are possible for all criteria.[19]

The purchasing companies are particularly important here. For example, C & A and the german Otto trading group demanded proof from the Triumph textile company that neither children nor forced laborers were employed in the production. The works council, together with the trade union, was then able to enforce a further self-imposed commitment of the management, which had refused to do so for many years. A monitoring group, consisting of employers and employees, was set up to investigate infringements. According to the opinion of the works council, the fear of negative headlines had a strong binding effect for company management.[20] Levi Strauss & Co. (Jeans), on the other hand, ceases business relationships with countries where systematic human rights violations take place (for example, China).[21]

6.4.4 International Ethical Codes

Multinational companies have economic power that exceeds that of many states. They have a great influence on their national governments through their economic importance and lobbying. Because they are multinational they can move their activities internationally and evade part of the state control.

The OECD Guidelines for Multinational Enterprises were adopted by the 42 Governments of the participating states at the meeting of the OECD Council on 25 May 2011 at ministerial level.[22] They include honest information to the public about business activities, environmental protection, concerns for consumer interests, duty of care with respect to the supply chain, adherence to human rights and ILO core labor standards,[23] combating corruption, etc.

The Global Compact was adopted in 2000 under the leadership of the UN Secretariat of the United Nations and is intended to provide an international framework for a voluntary ethical commitment in business. Ten principles have been developed in the fields of human rights, labor standards, environmental protection and the fight against corruption, which constitute an international consensus.[24] More than 9000 companies signed the Global Compact worldwide.[25] They are obliged to report on the implementation of the principles every year. Violations of these principles may be reported to the UN Secretariat by third parties, as in the case of Nike

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19 See Hoffmann, Johannes/Reisch, Lucia/A./Scherhorn, Gerhard (1998), p. 3.

20 See Jensen, Annette (2003), pp. 18 and Wieland, Josef, (1999), p. 22.

21 See Haas, Robert D. (1994), p. 2.

22 See OECD (2011), OECD-Leitsätze für multinationale Unternehmen, OECD Publishing. http://dx.doi.org/https://doi.org/10.1787/9789264122352-de (4.04.2013).

23 See http://www.ilo.org/berlin/lang--de/index.htm (4.04.2013) and Simma, Bruno/Heinemann, Andreas (1999), p. 413.

24 See http://www.unglobalcompact.org/Languages/german/index.html (4.04.2013).

25 See https://www.unglobalcompact.org/what-is-gc/participants

by an American labor activist. Nike had claimed in an information brochure that its working conditions in Indonesia and Vietnam had improved significantly, but this was not correct. The activist sued Nike. Nike sustained heavy image damage and had to pay $1.5 million in an out-of-court settlement to the Fair Labor Association.[26]

In 2011, a sustainability code (German Sustainability Code) was developed in Germany that includes 20 environmental, social and corporate management criteria and is to be reported annually. It is implemented by more than 40 German companies from Allianz AG to Deutsche Telekom to VW. The EU Commission wants it to be binding on European companies with a staff of 500 or more. This scheme would cover 18,000 of the nearly 40,000 larger companies. So far approx. 2500 European companies have published sustainability reports.[27]

Environmental compatibility and working conditions can be reviewed and tested by the companies on the basis of predefined standards by many officially approved experts. The environmental criterion (EC Eco Audit) described by the EU Commission or the SA 8000 Standard, which defines the ethical guidelines for working conditions, are applicable. In order to limit conflicts of interest caused by the payment of the experts by the audited companies, the SA 8000 initiative is based on the control of the experts through non-profit organizations that can object to the certification of a production site or even against the approval of an expert or a certification company. Companies that wish to be certified according to the SA 8000 are committed to healthy working conditions, no child labor, the admission of trade unions, fair working hours and no discrimination.[28]

Global guidelines require that there is an internationally common understanding of ethics. It must apply to all people, businesses and states, which is controversial. So-called cultural relativism sees the ethical norms as varied internationally and rejects a global prescription as paternalism. On the one hand, international corporations would have to adapt to the customs of the respective countries, including child labor and reduced safety and environmental standards. On the other hand, the so-called ethnocentrism sees its own norms and values as internationally superior and tries to transfer them to other countries. The universalism does not provide any values for this, but instead presumes globally valid values, e.g. human rights or the norm of an intact environment.[29]

The definition of uniform social and environmental standards as in the OECD Code is regarded by many emerging and developing countries as "value imperialism."[30] Ultimately, the Declaration of Human Rights from 1948 came under the leadership of the Western States, which strongly emphasize individualism and in

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[26] See Göbel, Elisabeth (2010), pp. 302 and 312.

[27] See http://www.nachhaltigkeitsrat.de/deutscher-nachhaltigkeitskodex (7.10.2013) and F.A.Z. from 17.04.2013.

[28] See http://www.sa-intl.org/index.cfm?fuseaction=Page.ViewPage&PageID=937 (7.10.2013) and Gilbert, Dirk, Ulrich (2001), p. 128, 132 and 138.

[29] See Kreikebaum, Hartmut/Behnam, Michael/Gilbert, Dirk Ulrich (2001), pp. 112.

[30] See Scherer, Andreas Georg (1997), p. 11, G. p. 307.

which collectivism and religion have a relatively minor significance.[31] Meanwhile, however, there are also human rights organizations in the newly industrializing and developing countries that claim human rights.[32]

As already indicated, the need for uniform ethical economic norms is to avoid distortions in competition. If there are no uniform regulatory frameworks, different ethical standards can lead to an adaptation to the lower standards. For example, the United States suffered competitive disadvantages in 1997 due to the unilateral introduction of the "Foreign Corrupt Practices Act," which have led to losses in billions after calculations. In Germany, however, bribes were tax-deductible as "useful expenses" until a few years ago.[33]

As long as global ethics benefit people abroad, little can be said against them. However, there will always be borderline cases where the cultural peculiarities and other constraints contradict the enforcement of ethical values, e.g. a prohibition of child labor. Here, people in non Western countries can be harmed by the guidelines. For example, if the survival of a family depends on child labor. If a foreign society is based on collectivism as there is no social welfare system, there are other duties for the individual. There is a stronger collective responsibility. In this case, a case-by-case analysis must take place, and the individualization and anonymization of the Western industrialized countries are certainly leading to considerable problems so that an ultimate freedom of the individual should not be the only universal goal. Individualization is also a consequence of the market economy. This tendency seems to be increasing in all countries that integrate with this system into the global division of labor. Nonetheless, the values of human rights and the environment should be universal ethical goals, because they are of benefit to people, regardless of cultural differences.

Summary

Morality as the behavior demanded by society can differ culturally, which is why companies acting on an international level are also confronted with different ethical expectations. With technological advances (Internet, satellite television, etc.), globalization of the economy, as well as a globalization of values and social movements has taken place. The increased importance of public relations is also reflected in the fact that many international corporations now publish social and environmental reports.

Comprehension Questions

1. What are the difficulties of international ethics?
2. What solutions are there to enforce ethics on the international level?
3. Describe the problems faced by Western companies when they produce or compete with emerging markets.

[31] See Göbel, Elisabeth (2010), pp. 308.

[32] See Göbel, Elisabeth (2010), pp. 309.

[33] See Noll, Bernd (2002), p. 184.

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Chapter 7
Tools of Ethics for Management

What Follows Why?
In the following, we will deal with the central question of business ethics: How can the behavior of employees be influenced in such a way that ethical behavior is encouraged:

1. To avert damage to economic activity for third parties (interest of society).
2. To avert damage to economic activity for the company (interest of the company).
3. To increase the productivity of interpersonal cooperation (interest of the company and society).

Learning Goals
You are asked to explain the instruments in your own words and to use them by means of examples (Fig. 7.1).

7.1 Institutional Ethics on Company Level

In the following, institutions will be analyzed as the first ethics tools, the rules that ensure ethical behavior for the company and thus indirectly for society as well.

7.1.1 Corporate Principles and Vision

Guiding principles are ethically sound behavioral principles, which give the employees a general action orientation (definition). They represent the company's own standards. They have a general effect on the conduct of business or in particular against the stakeholders. These norms should help the employees to make decisions

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6.1. Ethics of institutions	6.2. Ethics of organizations	6.3. Ethics of leadership
1. Corporate image 2. Operational and strategic objectives 3. Code of Conduct 4. Ethical control systems 5. Ethical stakeholder analysis	1. Organization structure 2. Ombudspersons 3. Ethics officers 4. Ethics Committee 5. Whistle blowing	1. Ethical corporate culture 2. Ethical leadership 3. Leadership evaluations 4. Ethical staff selection 5. Ethical personnel development 6. Ethics seminars 7. Corporate Volunteering 8. Training near-the-job

Fig. 7.1 Tools of ethics for the management

in ethically critical situations by weighing ethical goods.[1] They are generally held as goals, that is to say they may not always be practicable and stand as part of the target hierarchy over the concrete and workable corporate objectives.

The guidelines communicate corporate values internally and externally. Corporate image supplements the corporate constitution. How can guidelines be transferred to employees, how do they become an enterprise culture? For this purpose, there are other ethics tools that directly or indirectly influence corporate culture through motivation, control and sanctions. They are presented later.

A higher-level part of the mission statement can be the corporate vision (for example, as a metaphor). It is even more abstract and is intended to serve as a supreme goal, meaningful, motivating and united. E.g. Siemens: "We want to generate lasting value for the societies we are operating in."[2] or The Siemens Corporate Responsibility Report (2003) or the vision of the Faculty of Economics of the University of Applied Sciences (HTW). "We convey more than knowledge".

The guiding principles can be controlled by the public and prompted by the stakeholders. For example, the obvious contradiction between the guiding principle of honest customer advisors and the sale of risky certificates and derivatives in recent years has led to a loss of the credibility of many banks.

Group Work Corporate Image

Design a corporate image for your own business (Fig. 7.2).

Visions are intended to inspire and motivate the employees in the sense of ANTOINE DE SAINT-EXUPERY to take up and implement the company goals as their own:

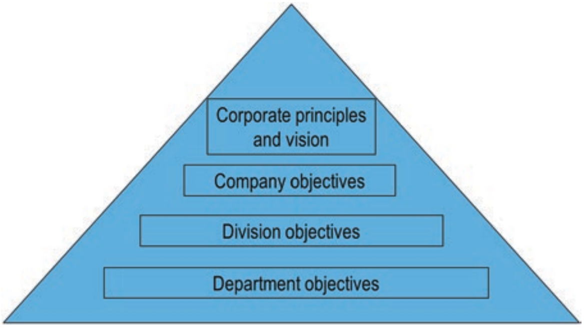
> "If you want to build a ship, don't drum up the men to gather wood, divide the work, and give orders. Instead, teach them to yearn for the vast and endless sea."

Here are some examples of international companies:

[1] See Leisinger, Klaus M. (1997), pp. 119 and Göbel, Elisabeth (2010), pp. 213.

[2] http://www.siemens.com/global/en/home/company/sustainability.html (20.12.2016).

Fig. 7.2 Targets of the company (based on Göbel (2010), p. 214)



Unilever
"We conduct our operations with honesty, integrity and openness, and with respect for the human rights and interests of our employees. We shall similarly respect the legitimate interests of those with whom we have relationships."[3]

Levis
"We believe that business can drive profits through principles, and that our values as a company and as individuals give us a competitive advantage."

Empathy – Walking in Other People's Shoes
Empathy begins with paying close attention to the world around us. We listen and respond to the needs of our customers, employees and other stakeholders.

Originality – Being Authentic and Innovative
The pioneering spirit that started in 1873 with the very first pair of blue jeans still permeates all aspects of our business. Through innovative products and practices, we break the mold.

Integrity – Doing the Right Thing
Integrity means doing right by our employees, brands, company and society as a whole. Ethical conduct and social responsibility characterize our way of doing business.

Courage – Standing Up for What We Believe
It takes courage to be great. Courage is the willingness to tell the truth and to challenge hierarchy, accepted practice and conventional wisdom. It means standing by our convictions and acting on our beliefs.

We are the embodiment of the energy and events of our time, inspiring people from all walks of life with a pioneering spirit. Generations have worn Levi's® jeans, turning them into a symbol of freedom and self-expression in the face of adversity, challenge and social change. Our customers forged a new territory called the

[3] http://www.unilever.com/aboutus/purposeandprinciples/ourprinciples/ (28.09.2012).

American West. They fought in wars for peace. They instigated counterculture revolutions. They tore down the Berlin Wall. Reverent, irreverent – they took a stand."[4]

Company guidelines can refer to the stakeholders or the focus of the company's activities, such as a chemical company that focuses on environmental protection and/or sustainability. Depending on the stakeholder, the following priorities can be selected:

Employees: human dignity, respect, job security, etc.
Customers: high product quality, reliability, innovation etc.
Society: environmental protection, compliance with laws and international standards, etc.
Suppliers: long-term, partnership-based cooperation, no dependency on dependencies, no corruption or gift acceptance, etc.[5]

In order to have an effect, it must be clearly stated in the mission statement that, in the event of a conflict, ethical principles have priority over profit maximization and that compliance with the guiding principles is monitored and violations are sanctioned.[6]

To ensure that the company's corporate principles are supported by the employees and are not perceived as impaired by the company's management, it is recommended that employees and possibly also the most important stakeholders be involved in the elaboration of guidelines. This shows an ethical discourse that enables the employees to understand the consequences of their actions and, finally, a weighing of goods. The company management guidelines must then be communicated and advertised in the company and externally. This also strengthens the corporate identity and improves the reputation of the company.[7] General Electric and Siemens, for example, both advertise with their wind energy efficiency fund. But there is also a great danger. The visions and principles sound ethical and convey the impression that the company is solely a good thing. The suspicion is always there that some companies present the ethical guidelines only for image and PR, but that they play no role in everyday functioning of the company.[8] However, if a case publicly contradicts the guidelines and is not an exception, this obvious contradiction seems hypocritical and weakens the credibility of the company. The guiding principles can be checked by the public and requested by the stakeholders. For example, the obvious contradiction between the guiding principle of honest customer advisors and the sale of risky certificates and derivatives in recent years has led to a loss of the credibility of many banks.

[4] http://www.levistrauss.com/about/values-vision (28.09.2012).
[5] See Göbel, Elisabeth (2010), p. 217.
[6] See Göbel, Elisabeth (2010), p. 218.
[7] See Göbel, Elisabeth (2010), pp. 220.
[8] See Wittmann, Stephan (1994), pp. 88.

7.1.2 *Operative and Strategic Targets*

7.1.2.1 Company Targets and Strategies

A company's operational objectives can be met using overarching guiding principles. In this way, they narrow down their model by including a measurable goal (growth in percent) and a time reference (years or months) in addition to an objective (for instance profit or turnover) and a material scope (total company or division).

In the mid-1980s, the Otto group defined environmental protection as a corporate objective. An environmental and social policy area was established for this purpose. As a secondary goal they adopted the enforcement of social standards in the worldwide trade with the suppliers. Internally, employee training was carried out, environmentally oriented input-output balances were prepared and incentives for environmentally conscious behavior were set. Nonetheless, the operability of objectives must be achieved through intermediate objectives.[9]

Other examples include reforestation projects from beer breweries such as Krombach or the agro-forestry development project of Ritter GmbH & Co. KG in Nicaragua. By paying "fair" prices, the local farmers are sustainably supported to cultivate cocoa without destroying more rainforest.[10]

Strategy is defined as:

> "a fundamental pattern of present and planned resource deployments and environmental interactions that indicate how the organization will achieve its objectives."[11]

Or simply:

The target-medium combination to achieve long-term goals.

More specifically, this is the definition of the economic sectors in which the company intends to operate and enjoy long-term use, which includes the distribution of company resources, in order to achieve competencies and thus competitive advantages.[12] Corporate, business area and functional area strategies are differentiated. The company strategies include, for example, decisions on products, markets, co-operations, organizational structure, personnel strategies and the company's constitution.

[9] See Lohrie, Achim/Merck, Johannes (2000), pp. 44.

[10] See Göbel, Elisabeth (2010), p. 172.

[11] Hofer, Charles Warren/Schnedel, Dan (1978), p. 25..

[12] See Bea, Franz Xaver/Haas, Jürgen (2009),pp. 53 and Göbel, Elisabeth (2010), p. 167.

7.1.2.2 Division Targets and Strategies

Company targets are broken down to the division level and defined operationally, for which strategies are determined. In the case of business strategy, the competition strategies normally attributable to Porter[13] are listed here. For a company, there are three different options to be successful in competition: (1) Cost leadership, (2) Product differentiation, to separate from the competitors, and (3) A niche strategy in which the company focuses its product on a specific buyer group. Other competitive strategies are quality leadership and concentration, thus the repression or takeover of competitors.

It can be worthwhile to focus a business on ethical products. Examples for this are: organic eggs, free-range eggs, eggs from soil conservation and organic meat. The environmental orientation of a company or environmentally friendly products is a differentiation strategy if consumers also have an environmental orientation. If this is very pronounced, a corresponding orientation for the company can become vital. If there is an environmentally conscious buyer group, this can be developed with a niche strategy. The increase in organic products, along with specialized chains like Alnatura, are also examples of businesses focused on ethical products.

The cost leader will always outperform a company with an environmental policy orientation for production in a pure market economy, because here, as already explained, market failure exists. However, if society and the economy are well developed and have a regulatory framework that internalizes the negative external effects through prohibitions, taxes and subsidies, environmental policy becomes a positive competitive factor.

Ultimately, public opinion is most responsible for sanctioning ethical misconduct. For this reason, particular importance is attached to the media. Public opinion also determines the behavior of consumers in the selection of products and thus indirectly the success of the company. An ethical perception of the consumer forces companies to adopt ethically-oriented production. To this end, a consumer group has been developed, called Lohas (Lifestyle of Health and Sustainability), which focuses its consumption on the criteria of health and ecological and social sustainability.[14] It is therefore all the more important that consumer labels are monitored by independent organizations or by the state to provide consumers with the appropriate and objective information for an ethical choice of products.

7.1.2.3 Department Strategies

Company goals are defined operationally, which in turn is broken down into functional areas. To achieve this, more strategies are defined. The business area strategies are subordinated and the functional area strategy is subordinated. The company plans to implement both company and competition strategies. These may be

[13] See Porter, Michael E. (2013).

[14] See Göbel, Elisabeth (2010), p. 326.

research, development, procurement, production and sales strategies. For example, the abandonment of animal experiments can be a successful sales concept, as exemplified by the cosmetics company Body Shop.[15] There seems to be a consumer group willing to pay for it.

Environmentally-oriented functional area strategies

(a) Research and development of environmentally friendly products and production processes are the basis for a sustainable use of our planet.
(b) resource and environmentally friendly production
(c) sales: environmentally friendly products (during manufacture or use), recyclable or combustible packaging, environmental awareness adertising

Corporate ethics is the consistent implementation of ethical goals in company policy and not a pure PR action. Again, there must be no contradictions. For example, it is hypocritical when a clothing producer who uses child labor in India to keep production cheap is trying to create a morally positive image in Germany by promoting SOS Children's Villages.

7.1.3 Code of Conduct

Even before the financial crisis, a so-called "ethical boom" arose in the US. According to a study, as early as 1989 more than 90% of responding US companies already had ethics principles. The same study was carried out by French, British and German companies. Only 41% had an ethics code (Germany 51%, the UK 30% and France 41%), with most of the code introduced after 1984.[16] At the beginning of the millennium, 90% of large US corporations introduced a "Code of Conduct" or "Code of Ethics". Employees should focus on values such as trust, fairness, honesty, integrity, and the good of the general public. The background is the insight that the image of the company has a great influence on market success. Ethical sensitivity and confidence in integrity are factors for success.[17]

Companies can also set ethical standards for themselves. The problem of enforcement is the same as in cartels. For example, the German Flower and Import Trade Association has established a code of conduct for the environmentally and socially responsible production of flowers and is striving to achieve compliance.[18] Forty companies of the Bavarian construction industry committed themselves, within the framework of an ethics management system, to prevent unfair competition practices such as undeclared work, dumping wages and corruption.[19]

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[15] See Göbel, Elisabeth (2010), p. 169, 179.

[16] See Center for Business Ethics (1992), p. 864 and Wittmann, Stephan (1994), p. 88.

[17] See Deiseroth, Dieter (2004), pp. 129.

[18] See Weißmann, Norbert (2000), p. 122.

[19] See Wieland, Josef/Grüninger, Stephan (2000), p. 167.

If executives do not follow the code of conduct, this not only undermines their credibility, but also calls into question the Code of Conduct. The contradiction between the conduct of the executives and the code can ultimately lead to frustration among employees and other stakeholders.

The Code of Conduct can be voluntarily or obligatorily given by the company or associations to the employees and then include sanctions within the scope of employment law in the case of infringements. These codes fulfill several functions.

- they enable companies to supplement and interpret general legislation, especially for employees.
- they enable companies to commit employees to uniform standards and to adhere to their ethical questions, thus enabling a corporate identity and a uniform outward appearance
- they enable companies to respond to ethical mistakes faster than the law.
- they enable companies to set their own standards, which in particular can be used to express a company-specific management ethic.
- they allow special sector specificities to be addressed, which are not addressed by general legislation.

Codes of professional associations with compulsory affiliation, such as physicians, can achieve a high degree of liability, since a breach of sanctions can be penalized with threats including exclusion from the association. They are thus effective instruments for implementing ethics in the company and for acceptance of the industry in society.

Ethical industry codes have been published by the chemical industry, the construction industry and the pharmaceutical industry. The chemical industry attaches importance to sustainable production, safety in production, transport, storage and consumption of chemical products. Furthermore, the production of chemical agents is outlawed.[20] The Code of Ethics, which is integrated into the ethics management system of the Bavarian construction industry, contains various behavioral standards, for instance in the areas of lawfulness and integrity, on the rejection of restrictive agreements, on dealing with clients, and on distributing or accepting gifts.[21]

There are several codes for the pharmaceutical industry in Germany. For example, the Ethics Code Association of the Diagnostica Industry (VDGH) is concerned mainly with the regulation of fair competition. The Voluntary Self-Monitoring Association for the Pharmaceutical Industry (FSA) was set up to monitor compliance with these regulations. The association for voluntary self-regulation in the pharmaceutical industry agreed to the national implementation of the European Transparency Code, which was drawn up by the European Federation of Pharmaceutical Industries and Associations EFPIA. The Code regulates all relationships between physicians and healthcare institutions and drug manufacturers. The

[20] See Strenger, Herrmann J. (1989) and http://www.bavc.de/bavc/web/web.nsf/id/li_domo-7hwgy4.html.

[21] See Wieland, Josef/Grüninger, Stephan (2000), pp. 167 and http://www.bauindustrie-bayern.de/themen/emb-wertemanagement/emb-wertemanagement-bau-ev.html.

main focus of the Code is on donations and payments in the context of training events, as well as in service and advisory consultations. Information on fees payable by manufacturers to physicians for their clinical trials or application observations was published. A doctor's individual publication of the donation with the nomination of the recipient and the name of his/her business address is provided. If the physicians of the publication disagree, the publication will be in an aggregated form.[22] The members of the Association for Medicines and Cooperation in Health Care (AGK e.V.) have agreed on a code which aims at compliance with legal and ethical requirements for the marketing of medicinal products.[23]

In addition, the World Health Organization published a Code of Conduct for the marketing of breastmilk substitute products in 1981, in particular to prevent the idea of mother's milk substitute products being superior from spreading.[24] The UN adopted an International Code of Conduct for the distribution and use of pesticides. The goal is the international risk reduction in the handling of pesticides.[25]

Conclusion
Business associations can commit themselves to complying with ethical standards without state compulsion. The question, however, is why they are doing this and why the state has apparently left a regulatory vacuum here. All rules must be implemented by ethical control systems, since they are otherwise pure PR measures.

7.1.4 Ethical Control Systems

7.1.4.1 Compliance Programs

In 1991 the Federal Sentencing Guidelines for Organizations (FSGO) entered into force in the United States, which provide for fiscal penalties for companies when they take institutional measures to prevent employees' economic crimes. This also made it clear that the companies are responsible for the actions of their employees. As a result, companies have issued binding internal regulations, so-called compliance programs or guidelines, for the legal requirements relating to their liability. Compliance programs have the aim of implementing ("to comply") state regulations for internal business in the company. They are thus based on incentive ethics. In Germany, this would be e.g. The Securities Trading Act, in particular the

[22] See Laschet, Helmut (2013); http://www.fsa-pharma.de/ and http://www.vfa.de/de/verband-mitglieder/transparenzkodex-der-pharmaindustrie/zusammenarbeit-zwischen-pharmazeutischer-industrie-und-aerzten-unverzichtbar.html.

[23] See http://www.ak-gesundheitswesen.de/verhaltenskodex/ and http://www.lofarma.de/unternehmen/pharma-kodex.

[24] See http://www.who.int/nutrition/publications/code_english.pdf and http://www.afs-stillen.de/front_content.php?idart=135 (11/3/2012).

[25] See http://www.bvl.bund.de/SharedDocs/Downloads/04_Pflanzenschutzmittel/CodeOfConduct_DE.pdf?__blob=publicationFile&v=2.

provisions on Insider Information, the Money Laundering Act and the German Investment Protection Act.

Contrary to German law, legal persons can also be prosecuted in the USA. US law is based on the assumption that the behavior of employees is also determined by company guidelines and corporate culture. For example, an effective ethics program, which ensures that legal violations in the company are detected and sanctioned, is mitigating in its effect. The cooperation of the enterprises in the detection of offenses is taken into account in the sentence.[26] The companies have an incentive with the FSGO to ensure clear responsibilities because they themselves are otherwise responsible for the ethical misconduct of employees.[27] The employees are still liable, but the companies cannot escape responsibility. However, this presupposes that the management cannot completely impose the costs of ethical misconduct on the company owner.

7.1.4.2 Integrity Programs

In an integrity program all measures are taken to implement the internally formulated ethical company specifications, which are not based on an external law.

As already explained, there can be no absolute control of employees in the company and regulations have the disadvantage that they can never cover all situations. The chairman of the board of Levi Strauss & Co., Haas, judged the compliance program of his company thus: “We became buried in paperwork, and anytime we faced a unique ethical issue, another rule or regulation was born.”[28] (See the comments on institutional ethics). Levi Strauss & Co. therefore opted for a value orientation in order to ensure the employees’ ethical behavior. Shared values and insight into the principles derived from them formed the basis of an ethos. The company identified its values as honesty, adherence to promises, fairness, respect for others, compassion and integrity.[29]

Integrity programs go far beyond compliance programs, in that they want to promote the moral self-responsibility of the employees with a broad, decentralized scope for decision making. They include ethical guidelines, objectives and control of their compliance, including the associated rewards and sanctions (Fig. 7.3).

In the case of the compliance programs, the employee is mostly avoiding punishment, without having to be convinced of the measure, while the Integrity Program wants to motivate the employees to adopt “integrity” behavior, which is based on individual ethics. For this reason it is advisable to involve the employee in the development of the Integrity Program and to inform him about the compliance program.

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[26] See Steinherr, Christian/Steinmann, Horst/Olbrich, Thomas (1997), pp. 1, 7, 16; Clausen, Andrea (2009), pp. 32; Zimmermann, Rudolf (2004); Paine, Lynn Sharp (1994), p. 110 and Noll, Bernd (2002), pp. 119.

[27] See Fetzer, Joachim (2004), pp. 34.

[28] Quoted after Jensen, Annette (2003), p. 2.

[29] See Jensen, Annette (2003), p. 2.

	Compliance program	Integrity program
Output base	Internal implementation of an external legal requirement	Internal implementation of an internal requirement
Aim	Avoidance of state penalties	Responsible, ethical behavior
Actor	Compliance officers	Management
Motivation	Avoidance of disadvantages	Ethos, values,
Design room	None	(In case of sanctions: avoidance of disadvantages)
Rewards / sanctions	Mandatory, sanctions (extrinsic)	None
Measures	Training, written guidelines, sanctions, controls, reports	Partially voluntary, appeals up to sanctions (intrinsic and extrinsic)

Fig. 7.3 Difference Compliance and Integrity Program (See Paine, Noll und Göbel (See Paine, Lynn Sharp (1994), p. 113; Göbel, Elisabeth (2010), p. 246f and Noll, Bernd (2002), p. 121))

The compliance program must be designed and controlled very tightly in accordance with legal requirements, while the integrity program allows for a self-defined decision-making margin. Paine emphasizes the need for executives to present and embody the values of the Integrity Program. They must also be able to enforce them in the company and to be able to do so in terms of character and intellect.[30] As a corporate motif, we can summarize the guiding principle for the compliance programs "Keep us out of trouble" and for the Integrity Programs "Make our business better."[31]

Summary
In the case of the integrity programs, which allow the company to have its own scope, it is particularly important for the employees' later acceptance that they be involved in the design process and that the objectives and decisions of the management are made clear. The compliance programs must be explained according to the legal requirements. Executives must be aware of the values of the Integrity Program. They should also be able to enforce them in the company, and they should also be able to do so in terms of character and intellect.

Comprehension Questions
1. How can companies benefit from ethical corporate objectives?
2. What are the advantages of codes of conduct for companies and associations?
3. How can companies benefit from ethical corporate objectives?
4. Explain the difference between compliance and integrity programs.

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[30] See Paine, Lynn Sharp (1994), p. 111.

[31] See Paine, Lynn Sharp (1994), p. 109ff; Steinmann, Horst/Kustermann, Brigitte (1999), p. 212, Clausen, Andrea (2009), pp. 32 and Göbel, Elisabeth (2010), pp. 248.

7.1.5 The Ethical Aspects of the Shareholder Value Concept

During the Enron crisis and the subprime crisis the shareholder value concept was the prevailing management concept. The shareholder value concept specifically criticizes profit as a means of controlling the performance of companies, based on the ability to control and determine it, and thus the options for control and manipulation of it. In the end, it argues, profits do not reflect the annual success of a company as a premium for the stockholders of a company, the shareholder or the investors, rather it is a fictitious evaluation unit, quite in contrast to cash flow. All too often the actual profitability of the company is not included in the profit. Management sees growth and investments often uncritically against pure sales growth, whereby unprofitable growth would destroy the value of the company and thus of the shareholders. The profit approach is neither suitable for evaluating investments, nor does it take the value of money over time into consideration.[32] The shareholder value concept proposes the use of a new measurement, the so-called free cash flow. This represents the amount of money that the stockholders will have leftover at the end of a period, in other words all revenues minus expenses, including the pure investments and both real and notional capital costs.

The inclusion of capital costs is a special feature of the shareholder value concept, and has far-reaching consequences. The shareholder value concept differentiates itself in particular from other cash flow approaches. The shareholder value concept takes not only external finance costs that effectively occur as regular expenses into account, but also the notional costs of equity capital. To calculate these notional costs, the average historical stock performance is increased by a risk premium for the respective branch of enterprise. The costs of equity capital are up to 10%, depending on the branch and the time frame it is based on. The shareholder value concept is thus also suitable to evaluate investments. You must earn at least the reduced cost of capital, whether you are talking about investments in capital assets or in other companies. The free cash flow is then reduced over the periods with the costs of capital and makes up the net return on the investments, or the shareholder value, thus the enterprise value. According to the shareholder value approach there is only one motto for the manager: maximize the shareholder value.

Unfortunately the shareholder value approach has four fatal flaws. First is its clarity, second its focus on the costs of capital, third the one-sidedness of its orientation towards companies and the maximization of the shareholder value, and fourth the short-term perspective of the approach.

Calamitous Clarity

How is one supposed to guess the exact cash flow of a company for all future periods? Since most future environmental factors are unknown, it is impossible to estimate cash flow with any exactitude. Despite this, there are quantitative periodic calculations of shareholder value with numbers that are always very clear. Even risk premiums or gradient scenarios relativize the results only a bit, and from a period

[32] See Rappaport, Alfed (1995), pp. 15.

not usually beyond the tenth cycle. For the sake of simplicity the growth rates are continued as an infinite sequence. Numbers are facts, and yet as Churchill said, “Don’t trust any statistics you haven’t faked yourself.” It is not even necessary to intend to fake statistics. A bit of optimism when predicting future figures, synergy effects or growth in company sales is sufficient. How else can the many overpriced takeovers be explained, such as Chrysler by Daimler or Voicestream by Deutsche Telekom? The consulting American investment banks were simply mistaken. The same must apply for the recommendation to sell, which the bank analysts at the end of the 1990s calculated at the height of the stock market boom. If the value were calculable using the shareholder value approach, all analysts in 2001 would have to have calculated huge overvaluations.

The problem of conflicting interests must also be recognized in the consultations for takeovers. The consulting investment banks were surely paid well for the takeovers of Chrysler and Voicestream, making it highly advisable to check the base calculations through a third party before the takeovers occurred. The calculations will have been correct, but there may have been many speculations in the assumptions underlying the calculations. Numbers are clear, but whenever we are dealing with estimations the numbers are usually wrong, which can lead to a false sense of security from the clear conclusions. But why did the stock analysts and rating agencies fail in extreme cases such as Enron and Worldcom, in which there was a huge level of investor fraud? Because figures are often not facts. Not even, as Rappaport says, “cash facts” are facts if we are dealing with future, and thus insecure, cash. Even if the balance sheets of a company (or an economy) have not been manipulated, pure numbers tell us little about the current state and almost nothing about the future state of things. These depend on many external factors that cannot be prognosticated or recorded from the people in the company who must deal with the future conditions; all of which are qualitative factors, not concrete, exact numbers.

The shareholder value is determined by financial figures. These numbers are the result of many past factors, including many qualitative factors, which are influenced by people. Numbers create a purely quantitative world and can thus only reflect a certain simplicity, not reality. Andreas Schüren, President of the management consulting firm Rölfs MCParnter said succinctly, “It is ridiculous to believe I have everything under control when I only have numbers under control.”[33] A one-sided orientation to these simplified, purely quantitative enterprise images thus contains the great danger of making poor decisions. If you only look in the rearview mirror you cannot steer a company. You can only see a small segment, and that segment is in the past. Even the estimations for future development are based on numbers from the past. Then we consider that there is constant pressure from the capital markets and competition to save on costs. This pressure, in connection with a strong belief in the power of numbers, a company policy oriented towards short-term success gave controlling an enormously important role for operative and especially for strategic decisions.

[33] Quoted and translated from Handelsblatt dated February 10/11/12, 2006, p. 3.

Controlling is a necessary but inadequate condition for economic success. Qualitative market leadership cannot be calculated on this basis any more than a well-tuned enterprise process with motivated employees. The best example for this is Opel. At the beginning of the 1990s, GM sent financer Louis Hughes with the notorious purchasing manager José Ignacio Lopez to Germany in order to cut costs at Opel. The short-term success they had was at the cost of quality, however. Opel cars broke down more frequently, and its market share dropped from 17% to 10.5%.[34] The simplest way to save on costs is still to stop investments and lay off half of the employees. The bottom falling out of business after deficient internal business procedures will only be reflected in company figures after 1 or 2 years.

The predictability of the shareholder value based on the free cash flow is the part of the shareholder value concept that impresses most. Especially investment banks and stock analysts use the concept for exactly this reason. At the end of the 1980s it became the dominant management and stock market evaluation concept. The approach is well meant and understandable, maybe even impressive, and its critique of the traditional company evaluation methods is justified. Unfortunately, exactly the well-meant, initially revolutionary improvements are often the most dangerous and the financial mathematics with their perennially clear results are the most dangerous simplifications. The supposed strengths of the shareholder value concept, calculating a seemingly secure company value including future figures is partially responsible for the stock market bubble in American and European stock markets at the end of the 1990s.

Short-Term Focus of Company Policy

Extremely short-term thinking has become the norm at the management levels of listed companies. A current study determined that most American managers will relinquish investments with a positive value proposition if it would mean missing the quarterly figures expected by the stock market.[35] This tendency is increased by discounting free cash flows with capital costs in the shareholder value approach, since the short-term profits are given too high of a priority (discounted cash flow). This is only consistent because the investors can reinvest the money they receive today, and thus produce additional profits. This procedure may be correct for capital market theory, but it means that temporary parts of the company that only exist for three cycles have the same value as parts that exist indefinitely but only produce a fraction of the amount. The shareholder value approach consistently sees only cash, and since cash today has more value that the profit of tomorrow, this leads to a short-term perspective and investments that will only be profitable later being undervalued. Gifted managers who instinctively make long-term strategic company decisions have little role to play in this scenario.

Long-term investments tend to reduce the cash flow and thus the shareholder value. A manager maximizes his shareholder value and thus the share price (perhaps his stock options as well) when he cuts all non-vital expenditures. This includes

[34] See Handelsblatt dated 10/11/12, 2006, p. 3.

[35] See Graham, John R./Harvey, Campbell R./Rajgopal, Shiva (2004).

expenditures that have a positive effect on company returns over the long term, or those that may not be directly visible at all, such as investing in employees with continued education expenses and social provisions. Unethical dismissal of employees can raise the shareholder value in the short term. It is not initially important if the number of employees is sufficient for the long-term in order to fulfill all operative and strategic functions as long as the quantity is sufficient to fulfill the operative tasks necessary to keep profit at the current level. Whether the employees are overworked in this situation is not important, since the negative effects of overwork, stress and a poor work environment only show themselves in the long-term. The employees are no longer a qualitative production factor in the shareholder value approach, but rather a quantitative cost factor. Increased conflicts with stakeholders, the groups with which the company is in a mutual or even dependent relationship, will only occur over the longer term. One of the main differences between the stakeholder and shareholder approaches is thus in the time frame used. The 6-month analyst perspectives strengthen the short-term focus of enterprise decisions in stock quotation even more. However, other investments such as research and development or quality control are not important for company success in the short term. The future profit contribution from such investments is difficult for external persons such as analysts to judge. Decisions and influences are only considered important if they will reflect in profits within the next 6 months. Six months is a long time for stock prices, but nothing for the strategic development of a company. Without long-term investments there is no future growth.

A manager has to show the public activity, otherwise he cannot justify his position and salary. What if it were actually better for him to do nothing? The result is a company policy focused on short-term results and bolstered by the short duration of management contracts. The daily and weekly press with a very short-term perspective plays a role here as well. Can the manager of a public company go against the trend as a publicly owned firm and refuse to do the activities that all the other managers use to get famous in the eye of the public? It would at least be very difficult. There is a danger that short-term company policy dominates and the necessary yet difficult decisions for the long term are not taken. Even Rappaport mentioned the danger of a short-term reduction of costs to increase shareholder value with negative effects on the long-term development of a company in his second edition of "Shareholder Value." As an example he uses the dismissal of sales personnel with good customer contacts, but he does not consider this a weakness of the shareholder value approach, rather he considers it an incorrect or absent application of the shareholder value approach.[36]

The shareholder value concept is a contract theory. Since all activities to be performed under contract with a third party such as suppliers, employees etc. have been removed, only the owner or principal is entitled to the residual earnings. The stakeholder concept on the other hand, considers the company to be a coalition of interest groups such as suppliers, employees, customers, communes, states etc. who create the value of the company together, which means that the interests of the groups

[36] See Rappaport, Alfred (1995), p. 11.

involved must be included in the company goals in addition to the profit or cash flow maximization. The shareholder value approach tends to represent more the American view of companies and the stakeholder approach more the European view.[37] Both approaches are correct, but they only cover part of the world of enterprises.

The shareholder value approach makes clear that the priority of a company is to produce added values. The employees of a company must understand that they cannot demand a salary from the company that exceeds their contribution to value creation. In particular in times of harder international competition through globalization, the structures must be repeatedly examined for efficiency. The relative production advantages, and thus the international distribution of labor, are constantly changing. The employees themselves are in direct competition with workers from other countries. This competition is all the harder as the transportation costs of the goods produced drop, international capital becomes more mobile and the costs more transparent. An employee in the home country who costs double of someone abroad must provide double the value creation. Considering production for a world market, unemployment is a structural problem much more than an issue of demand.

One-Sided Maximization of Shareholder Value

Maximizing shareholder value is a natural and legitimate demand of the investors as providers of capital, since it is the reason for their investment in the company stock. They waive immediate consumption and accept the enterprising risk in the expectation of receiving added value, a yield. When the shareholder value concept was formulated, many managers went their way in companies and tended to follow their interests more than that of the investors, at least according to the supporters of the shareholder value approach. The managers could not be sufficiently controlled with the criteria of sales growth and profit. In addition, these factors had no direct connection to the goal of the shareholder to maximize returns, since they did not represent cash flow. This also seemed to reflect the market economy guidelines. According to Milton Friedman there is only one company goal in the market economy, maximizing profit:

> " … and nature of a free economy. In such an economy, there is one and only one social responsibility of business – to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engage in open and free competition, without deception or fraud."[38]

This one-sided focus on a single goal is problematic, however.

The value of a company cannot be reduced to the cash flows available as flow figures, because it leads to incorrect interpretations. An uncompromising, one-sided pursuance of the shareholder value causes friction. If the company is driven only by the goal of maximizing shareholder value, thus the interests of the capital providers, obviously many other interest groups will be shut out and public relations will worsen. The damage done to society by the banks in the financial crisis was one unethical outcome of this narrow-minded approach. It is a dangerous illusion for a

[37] See Noll, Bernd (2002), pp. 88.

[38] Friedman, Milton (1963), p. 133.

manager to believe that he could steer his company any way he wanted. A company does not work in isolation, rather it is dependent on various interest groups such as suppliers, customers, credit suppliers (banks) and in the end its own employees as well, all of whom are people who often act irrationally and unpredictably. The stakeholder approach, formulated at the end of the 1980s, emphasizes this view.[39] The society itself can be seen as a stakeholder. The environment of a company considers it to be a part of the community. It lives not only in the community, but from the community, creating mutual dependency. The community is not only the income side either, since the employees are the most important input factor. The legal framework is also determined by the community. This still holds in the age of globalization, though the community must be defined more broadly, or more internationally.

An uncompromising one-way tracking of the shareholder value leads to high friction losses. If the public is only concerned with the one goal of maximizing the shareholder value, ie, the interests of the investors, it will compel many other stakeholders to get rid of public relations. It is a dangerous illusion when a manager believes that he can control his company at will. A company does not work in isolation, but on the basis of various stakeholders, such as suppliers, customers, lenders (banks), and finally the company's own employees.

7.1.6 Ethical Stakeholder Approach

The so-called **stakeholder approach**, formulated at the end of the 1980s, emphasizes this view. Among the stakeholders is Freeman, who defined the term as "any group or individual who can be affected by the achievement of the organization's objectives" or informally "those groups which make a difference".[40] "The fundamental idea is that stakeholders have a stake in the operation of the firm."[41]

The ethical stakeholder approach is an ethical goal balancing, in order to identify and avoid the negative effects of corporate activities on third parties in time (**definition**).

The shareholder value concept is a contract approach. Since all contractually rendered services have already been subtracted from third parties, such as suppliers, employees, etc., the owner, the principal, is entitled to this residual income. The stakeholer approach, on the other hand, sees the company as a coalition of stakeholders, such as suppliers, employees, customers, municipalities, the state, etc., which together generate the value added to the company, which is why not only the profit or cash flow optimization, but also the interests of the groups involved should

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[39] R.E. Freeman, who coined the term stakeholder for a broader public in 1984, does state however, that "There is no such thing as the stakeholder theory." Freeman, R. Edward (1994), p. 413. It is more of a strategic orientation towards the interest groups important to the company. See Waxenberger, Bernhard (2001), p. 39.

[40] Freeman, Edward, R. (1984), p. 46.

[41] Post, James, E./Preston, Lee E/Sachs, Sybille (2002), p. 19.

be taken into account in the company's objectives. The shareholder-value approach more and more represents the American view of business and the stakeholder approach more the European.[42] Both approaches are useful, but cover only a part of the business world.

As a rule, the business stakeholder approach only takes into account stakeholder interests that are either conducive to the company's economic success or which are so influential as to adversely affect the company's economic development.[43]

> "To be an effective strategist you must deal with those groups that can affect you, while to be responsive (and effective in the long run) you must deal with those group you can affect."[44]

Stakeholder management then has the task of counteracting the negative impact of stakeholders in order to promote the economic development of the company. This is called stakeholder value maximization.[45] Thus, regardless of the morality of a company, it can be worthwhile to disregard stakeholders' interests and/or to avert them. However, this can lead to damage that far exceeds the company's profit. The fact that the business-based stakeholder value approach considers the stakeholder interests only from the point of view of the impact on the monetary success of the company reduces the concept to a partial area of maximizing the shareholder value. That this is not sufficient, at least by the example of the use of forced labor by some German companies during the Nazi period makes clear. Here, the economic interest was dominant and at that time the stakeholder interests of the forced laborers could be ignored without negative consequences.

Case Study: Shell in Nigeria

Nigeria is Africa's largest oil exporter and has the world's tenth largest oil reserves. America, Brazil and Europe are among the main oil buyers. Two-thirds of Nigerian government revenues come from oil production. Shell has been present in Nigeria since 1937. Shell Nigeria is the operator of a joint venture between the government-owned Nigerian National Petroleum Corporation – NNPC (55% share), SPDC (30%), Total E&P Nigeria Ltd (10%) and the ENI subsidiary Agip Oil Company Limited (5%). The joint venture company is focused on onshore and shallow water oil and gas production in the Niger Delta.

Shell operates approximately 50 oil fields and 5000 kilometers of oil pipelines in the Niger Delta. According to Amnesty International, the company has reported nearly 1700 oil spills since 2007, but the actual number of accidents is likely to be higher.

The non-governmental organizations (NGOs) Amnesty, Center for Environment, Human Rights and Development stated in 2015 that these sectors were still contaminated even though Shell took measures to clean up. These contaminations are still there according to the NGOs, because Shell carried out the clean up inadequately.

[42] See Noll, Bernd (2002), p. 88ff.

[43] See Post, James, E./Preston, Lee E/Sachs, Sybille (2002), p. 19 and Hill, Wilhelm (1996), p. 414.

[44] Freeman, Edward, R. (1984), p. 46.

[45] See Schaltegger, Stefan (1999), p. 14 and Göbel, Elisabeth (2010), p. 144.

The drill hole number 11 of the Bomu field is one example. Here, after the end of the work, almost half a century of pollution and oil have been found in the waters, despite several refurbishments by Shell. Shell withdrew from some parts of the Niger Delta in the 1990s, but is still responsible for safeguarding the facilities used at that time. The NGOs accuse Shell of not complying with the legal obligation to secure the outdated infrastructure.

Three quarters of the oil escaping from the exploration cites is due to pillages or manipulation. Shell has the duty to eliminate all occurring oil leaks. For Greenpeace, however, the cause of the accidents is not relevant to the environment. In addition, the NGO criticizes the fact that a very considerable amount of gas was burned during the oil spill without purpose yet it increased climate change.

The people in Nigeria suffer greatly from environmental pollution. To this end, Shell pays compensation, such as £55 m to fishermen and farmers, but it does not restore the contaminated areas. The population is being harmed by Shell. According to the human rights organizations, the national environmental protection authority is understaffed and corrupt.

The Ogoni tribe railed against oil production, which devastated their habitat. In 1993 Shell withdrew from the Ogoni area. After the killing of a mob in clashes in 1994, the police arrested the leader of the movement Ken Saro-Wiwa. In prison he wrote the book “Flames of Hell,” in which he accused Shell of cooperating relentlessly with the military junta in promoting oil. In 1995, he was hanged by the Nigerian military junta along with eight of his colleagues. In 2015, after 13 years of legal action, Shell agreed to pay a total of approximately 15.5 million dollars to the survivors of the nine men. Shell had nothing to do with the acts of violence, but wanted to make a “humanitarian gesture” to pacify the country. Nevertheless, there are still ongoing battles between the government and the rebels, which interrupt oil production. The rebels fight for participation of the population in the oil profits, but also live from abductions. In December 2016 a suit against Shell began in London, where 40,000 residents of the affected areas of Ogale and Bille demand compensation for oil pollution and cleaning from Shell.

Tasks

1. How do you rate the stakeholder dialog of Shell? Has Shell behaved ethically?
2. How do you assess the importance of NGOs?
3. Has Shell’s behavior paid off?

Sources

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Summary
There are always social groups whose interests a company does not have to take into account, because they have no influence on the profit. Unethical behavior therefore has no negative impact on the company. In the long term, however, the company is caught up with the unethical behavior. Shell has been promoting oil in the Niger Delta for decades. The company was initially able to ignore the tribes in the Niger Delta as a stakeholder. However, the pressure of the Western public grew not least due to the actions of NGOs. Finally, injured Nigerian Shell filed a claim against a Dutch court Shell for damages and won the 2013 trial.[46]

Ethical stakeholder analysis (ethical stakeholder approach) examines who is affected by the company's decisions and tries to make the ethically correct decision by weighing all the benefits and damages to third parties and the company. This is where business ethics is concerned with the question of the extent to which corporate decision-makers as human beings can harm other people. Market failures due to external effects must also be considered. In addition to the avoidance of a third harm in the sense of ethics, the foundation is to compensate all stakeholders in the sense of a situation as described in Sect. 2.2.3 defined justice (Fig. 7.4).

1. **Interdependent Analysis and Opening of the Stakeholder Dialogue**

Who is affected by company decisions? When we speak of a moral responsibility of the company, we mean the impact of corporate activities on dependent groups. Stakeholders must be identified within the framework of ethical stakeholder analysis,within which the interests and demands of the stakeholders are addressed. In interdependent analysis, the impact of all alternatives of business behavior on stakeholders must be recorded and analyzed. Here, among other things, are the probability of occurrence and the extent of possible effects. In the interdependency analysis, the stakeholders must first be determined in a stakeholder map, for example.

Here is how we determine the probability of occurrence and the extent of effects: What interests are stakeholders pursuing? Are their interests consistent with the company's interests or are there conflicts of objectives? What/who are the stakeholders? Do they have conflicting interests? How is the long-term development of stakeholders and their interests assessed?[47] What are the impacts of the company's

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[46] See http://www.sueddeutsche.de/wirtschaft/oelverschmutzung-in-nigeria-shell-zahlt-millionen-an-fischer-aus-dem-niger-delta-1.2293097 and http://www.bund.net/shell

[47] See Göbel, Elisabeth (2010), pp. 140.

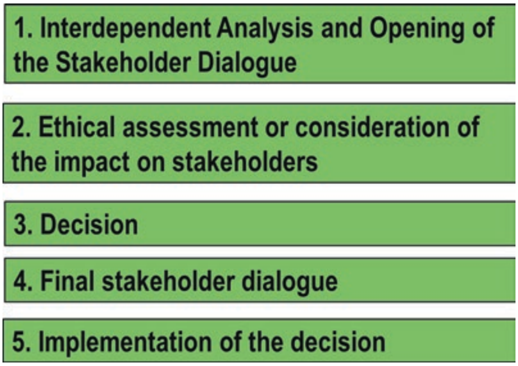

Fig. 7.4 Ethical stakeholder analysis in company decisions

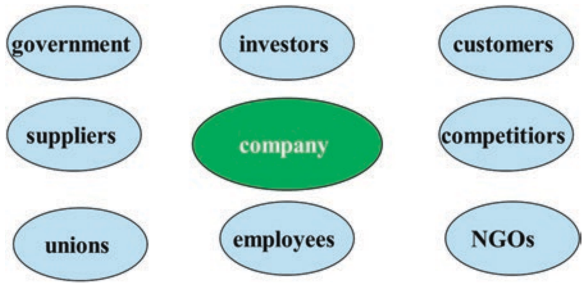

Fig. 7.5 Stakeholder Map (NGO: Non-Governmental Organizations)

decision-making alternatives on stakeholders? In order to provide information on the stakeholders beyond publicly accessible sources, the company asks the stakeholders about their interests and the effects of possible corporate decisions, thus initiating the stakeholder dialogue (opening of the stakeholder dialogue) (Fig. 7.5).

2. **Ethical assessment as consideration of the impact on stakeholders**

The next step is the ethical assessment as classification of interests according to the urgency of concerns to be considered by the company. The overall goals and value system of the company must be taken as a basis. The interests and requirements of the stakeholders need to be analyzed and evaluated. Here we clarify which interests are legitimate, i.e. are ethically justified. This is done within the framework of a discourse ethics with the stakeholders, in which all claims are initially presented by the stakeholders. In a further step, the groups of claimants are to be placed in the role of the other (ideal roletaking) in order to then work out the justification and legitimacy by balancing the benefits and damages in a discourse as a constructive discussion. Explicitly, bargaining is to be avoided here, defined as the enforcement of one's own interests at the expense of others.[48] The conditions for open and fair ethically-oriented dialogue are, in particular, the willingness to put one's own interests behind the legitimate interests of others. However, this cannot be assumed

[48] See Ulrich, Peter (1998), p. 13 and Göbel, Elisabeth (2010), p. 128.

Fig. 7.6 Fundamental relation between goods

from the interest groups involved in discourse ethics. In reality, the ethical motivation of the company's management will therefore be to take on the role of the stakeholders and to carry out a weighing-up.

In balancing the interests and action alternatives (weighing goods vs evils), i.e. the consideration of the ethical advantages and disadvantages of the enterprise, a condition is sought which "combines public well-being with fairness with the greatest possible preservation of the well-being of the individual."[49] The aim is to maximize the value of the goods while remaining conscious of individual and community interests. This is not the utilitarian "happiness of the greatest number."

This is about balancing the impact of the company's behavior on goods or values. The basic criterion is that of fundamentalism, which means that in the event of a conflict, the good (or the goal) that serves the achievement of others is to be favored. The impact on the good of peace is, for example, higher in comparison to the good of prosperity, since there is no prosperity without peace.

According to Aristotle, another way of bringing the goods into a hierarchy is to ask for their meaning or contribution to a successful life. Thus one could place freedom over life as a value when one says that life makes no sense without freedom. However, these assessments are subjective, so that the relevant relations have to be determined (Fig. 7.6).[50]

3. **Decision**

After the stakeholders and their interests have been identified, their significance and development analyzed, and their ethical contribution evaluated, the next step is to make a decision and prepare a list of priorities with concrete measures according to the ethical considerations. The company or the management must decide on a behavioral alternative. In doing so, the company's own interests, in particular profit maximization, must be weighed against those of the stakeholders. The management of the company must opt for the best, and thus also the most ethical alternative.

4. **Final stakeholder dialogue**

Finally, the decision has to be explained to the stakeholders along with the planned measures (second and final stakeholder dialogue). It is precisely the nonfulfillment of concerns that may require an intensive explanation. Continuous communication with the most important stakeholders is generally required. In this case, the involvement of external consultants can be advantageous because the external impact of a company is difficult to see from the inside.

[49] See Korff, Wilhelm (1999), pp. 310 and Göbel, Elisabeth (2010), p. 156.

[50] See Böckle, Franz (1978), p. 286.

5. **Implementation of the decision**

Finally, the decisions according to the list of priorities are to be implemented through concrete measures (implementation of the decision).

Examples of An Ethical Stakeholder Analysis
Environment

With the help of a product lifecycle analysis, a company can determine the effects of production on humans or nature at every production stage. For example, Shell has identified 350 stakeholder groups from business, politics and environment in the project of exploration of gas deposits in the Amazon basin in Peru ("Camisea Project"), contacted 200 groups directly and classified 40 groups as primary stakeholders.[51] Following an intensive ethical stakeholder analysis, Shell concluded that the environmental impacts and the negative impact on the natives were predominant and dispensed with the exploitation of gas deposits in the Amazon basin.[52]

If the company comes to the conclusion that the production or sale of a product is unacceptable, the market is left with an ethical valuation. For instance, Henkel discontinued the sale of solvent-containing adhesives because children were intoxicated by the inhalation of the solvents. Because solvent-free adhesive has poorer product properties, Henkel lost market shares. Novartis and Agrevo took high-pesticides from the market in Colombia, which were used in the field of flower production.[53] The Otto group discontinued distribution of CFC-containing spray cans, real fur clothing and tropical wood products. As of 2003, the Home Depot retail chain no longer sells any building accessories with tropical wood parts.[54]

Human rights

Due to the violations of human rights in South Africa, numerous companies of anti-apartheidism joined and withdrew from South Africa, which ultimately led to the overthrow of the regime.[55] Levi Strauss & Co. (jeans) breaks business relationships with countries where systematic human rights violations take place (China for example).[56] In view of the human rights violations of the military dictatorship in Burma, the linen manufacturer Triumph closed its factory there.[57]

An action is ultimately only ethically justifiable if the interests of the shareholder are weighed with those of the stakeholders. One cannot principally be subordinated to the other, but the priority must be examined ethically in each case. Criteria for an ethical test will be the greatest concern.

All social and ethical interests that may be justified are of interest. Legally enforceable interests are only part of all legitimate interests. There is much that is legal but immoral. Case law covers only part of immoral trafficking. Laws can only arise from ethical discussions in society. Reason, conscience, and public discourse

[51] See Post, James, E./Preston, Lee E/Sachs, Sybille (2002), pp. 157.

[52] See Post, James/Preston, Lee E./Sachs, Sybille (2002), p. 161.

[53] See Weißmann, Norbert (2000), p. 122. G185

[54] See Post, James/Preston, Lee E./Sachs, Sybille (2002), p. 92, 161.

[55] See Noll, Bernd (2002), p. 148.

[56] See Haas, Robert D. (1994), p. 2.

[57] See Jensen, Annette (2003), p. 20.

are how we recognize legitimate interests.[58] Legitimacy does not necessarily align with legality. Laws can also be immoral, such as the laws on racial segregation in the US and South Africa. Economic activities can be legal but unethical, such as child labor in some countries. Finally, a court action is often not worthwhile or the injured party is not able to gather the necessary financial resources.

An ethical stakeholder analysis enables the company to recognize potential conflicts in time and thus also to avert them. The stakeholder dialogue strengthens the company's reputation. This can be seen in the example of the cigarette industry: more and more studies have proven the health damage caused by smoking, so that the non-smoker lobby got bigger and gained political influence.[59] In this case, the opposing stakeholders' interests are contrasted with the economic interests of the tobacco industry. Despite the fact that they used very high budgets for PR work to stop this development, the health issue of the stakeholders finally succeeded.

Summary
Companies are dependent on society. This is also true in the age of globalization, whereby society is defined more broadly, that is to say more internationally. According to the principle "Do ut des", a minimum of social responsibility can and must be demanded, which also explains the critical attitude of large sections of the population to entrepreneurial violations. However, society's sense of responsibility cannot be assumed by companies, but must be demanded by society in the public and in the form of laws. If this does not happen, the company does not have a monetary incentive to behave in a socially desirable way, but rather can maximize its profit at the expense of society (such as the non-environmental disposal of production waste, competition offences or even balance sheet manipulation).

Group Work Ethical Evaluation
In group work, consider the effects listed below, using the examples listed below: Which goods are affected by which groups? What are the effects? How would they weigh in against each other and what would they propose as a solution?

1. Animal experiments in the cosmetics industry and drug research
2. Environmental protection
3. Alcohol and tobacco

Solution
1. Animal experiments in the cosmetics industry and drug research.

Animal experiments harm the good life and well-being of creatures. In contrast to this, the cosmetics industry is confronted with first a new, then tested product with its benefits for companies and society. In the pharmaceutical industry, this can mean saving human lives or at least the improvement of their health. Here one can justify the death and suffering of animals for drug research, but not for the cosmetics

[58] See Göbel, Elisabeth (2010), p. 145.
[59] See Göbel, Elisabeth (2010), pp. 140.

industry. In this consideration, the probabilities and extent of the benefits and damages must, of course, be taken into account.

2. The same applies to environmental protection. Here the short-term interests of company profits and jobs are up against the long-term effects on the goods environment and thus indirectly on the life, well-being and health of the people. Weighing the impact on the goods is made more difficult by the time lag and by measuring problems in the event of environmental degradation.
3. Alcohol and tobacco harm health, which can cost life. Both are very important goods. Tobacco also harms others who are forced to inhale smoke (passive smoking). On the other hand, the goods stand for company profits, taxes and jobs. On top of that, however, there is still the good of freedom for one's own way of life or for a personal balancing of goods. In moderation, tobacco and alcohol can be consumed at a limited risk. This balancing assumes, however, that the consumers have the rationality and information to make a decision to their advantage. As adolescents have only limited rationality, the purchase of these products is forbidden to them.[60]

Discourse ethics and the consequences of ethics are applied in ethical stakeholder analysis. Responsible action is only possible by including the effects of one's own behavior on third parties. However, this can only be achieved by analyzing public sources, studies or expert surveys, and ultimately through dialogue with the stakeholders.

Comprehension Questions
1. What are the differences between the business shareholder approach and the stakeholder approach?
2. How does this limit the ethical stakeholder approach? Why is it necessary for the long-term success of a company?
3. Describe the ethical stakeholder analysis in your own words.

7.2 Organizational Ethics

What Follows Why?
The following question is concerned with the extent to which the organizational structure of companies can hinder or promote the ethical behavior of employees and management staff. The Waters study can be used for this purpose.[61] In 1978 he examined the background for the price conventions of the US electrical industry (including General Electric), which are being criticized here, on the basis of the testimony before the US Congress. It identified seven barriers in companies that hamper moral or legal behavior. Four of these barriers refer to corporate culture and

[60] See Göbel, Elisabeth (2010), pp. 169.
[61] See Waters, James A. (1991) and Oppenrieder, Bernd (1986), pp. 25.

are presented later. The remaining three refer to the organizational structure of the company:

1. Division of work; specialization (division of work)
2. Separation of decisions and execution (separation of decisions)
3. Principle of command and obedience (strict line of command)

The business management organization now sees an important prerequisite for the learning ability of companies (“organizational learning” or “double-loop learning”) in the company’s organization, ie the structure and the rules.

- A steep hierarchy,
- a strong centralization of decisions,
- a clear division of labor,
- punishment of anyone who reveals errors and
- a climate of fear and competition,
- prevent or hinder the use of individual learning by organizing and implementing as collective learning.[62]

7.2.1 Organizational Structure

7.2.1.1 Division of Labor and Specialization

Work division, specialization in particular, represents one of the most important productivity factors of the organization form. The different strengths of people are coordinated and aggregated within the company. Specialization enables learning advantages and the work division allows quick processing of complex tasks. They also have disadvantages. If a task is distributed to many, the specialists have no overall view. If every employee sees only his small section, there can be mistakes and misunderstandings if there is a lack of coordination. Furthermore, it is easy to create blinders, which leads to the dominance of special interests and lack of a global view (selectivity of the viewing angle). This impairs synergy. If everyone thinks someone else is responsible, something significant can be missed, such as security control or the environmental impact of products. If a process is subdivided into many small parts, the employees are only responsible for those parts, and not for the process as a whole, which allows responsibility to be avoided. Often, no areas of responsibility are defined within the job descriptions, so responsibility cannot be attributed to anyone. Some employees consider this positive.

It is precisely departmental thinking that has a negative impact in this context. No one is responsible for any maladministration. The organizational structure acts as an ethical barrier. On the contrary, the organizational structure can even be

[62] See Argyris, Christ (1994), pp. 8 and pp. 27.

influenced by the evil-doers in an attempt to circumvent ethical concerns.[63] This applies in particular to the division of staff between staff and line organization units. The expert only advises and does not decide, so is not responsible, and the decision-maker depends on the information from the expert. Since decisions are often logical from the information, the expert has great power.[64] Since he does not decide, he does not feel ethically responsible. He also lacks an overview as he contributes only a part of the information to the decision, with the rest of the information coming from other experts.

Examples

– In the case of banks' credit decisions, there are many hierarchy levels and often even several managers at the same hierarchy level signing. This means that the decision is checked by many, but no one can be personally blamed if the credit fails.
– The cause of death of an employee of the Amoco Fina refinery from leukemia was determined to be production-induced benzene poisoning. Eight years after the death of the employee there was a liability trial. The defendants were a safety engineer, who claimed the dangers were minimal, the manager, who did not take the dangers of the health service seriously, and his superiors in the US, who refused to change production protocol for reasons of cost, and finally the head of the research department, who did not sufficiently investigate benzene. Ultimately none of these persons could be found guilty in 1989, because no one could prove that he was responsible for the decision to continue the production of benzene.[65]

7.2.1.2 Separation of Decisions and Execution in Vertical Organization (Hierarchy)

The less decision-making power the individual has the less responsibility he has. In a strict hierarchy the responsibility is always with the higher level, so that all responsibility lies with the management, the executive committee or the supervisory board. However, they have neither the information nor the reference to carry out a follow-up on the decisions of the lower level. As a rule they are not involved at all, so no one is responsible. The employees at the lower levels are only given quantitative targets. As in the case of the company Sears, Roebuck & Company this can lead to a deliberately excessive quantitative goal, coupled with corresponding pressure on the employees to mislead the buyer to purchase, thus to unethical behavior.[66] Result-oriented quantitative management systems support unethical behavior, since they put employees under pressure to reach the given figures. If management only

[63] See Waters, James A. (1991), pp. 290.
[64] See Oppenrieder, Bernd (1986), pp. 27 and Waters, James A. (1991), pp. 32.
[65] See Fetzer, Joachim (2004), p. 34.
[66] See Oppenrieder, Bernd (1986), pp. 27 and Paine, Lynn Sharp (1994).

controls the performance results, this corresponds to a goal that the end justifies the means.[67]

Added to this is the information filtering effect of hierarchies.[68] As in the case of Enron, the employees are often careful not to give negative information upwards, so as not to have any repercussions. This is countered by a supervisor because he does not have to act or be responsible, which can lead to immoral behavior not being reported in the company.

There are two problem-solving approaches. On the one hand, the so-called re-integration, in which the division of labor is again brought together into holistic work processes, so that there is a person responsible for the final result and the reduction of hierarchies on the other hand. Deciding and executing should be reintegrated.[69] This coincides with the ethical approach of seeing man as a self-determined moral creature. Responsibility for the consequences of one's own behavior is the basis for ethical behavior.[70]

7.2.1.3 Command and Obedience (Strict Line of Command)

Waters quotes a witness who was asked why he did not report the illegal behavior: "I had no power to go higher. I do not report to anyone else than my superior." and "I had to assume that whatever he told me came from his superior, just as my subordinate would have to assume that what I told him came from my superior."[71]

The principle of command and obedience (strict line of command) leads to a lack of responsibility for the lower levels, which are the only ones that have the information for an ethical impact assessment (see command need).

Added to this is the fourth organizational problem of information transfer.

7.2.1.4 The Information Problem

As early as the beginning of the nineties, German executives complained of a loss of values, especially a lack of sincerity, honesty and openness, which had a negative effect on the horizontal and vertical transfer of information within the company. Negative information was withheld. Information was manipulated. Departments were trying to play off each other using false information.[72]

If a company determines that the reporting path must be complied with when the information is disseminated, this means that the lower hierarchy level decides what the higher level knows. For example, the division decides what information the

[67] See Waters, James A. (1991), pp. 288.

[68] See Waters, James A. (1991), pp. 285.

[69] See Steinmann, Horst/Löhr, Albert (1991), p. 120.

[70] See Göbel, Elisabeth (2010), pp. 269.

[71] Quoted from Waters, James A. (1991), p. 285.

[72] See Dahm, Karl-Wilhelm (1993),pp. 4.

Fig. 7.7 The information problem

board receives. Information (knowledge) also means power. No one can act on mistakes without information. False information leads to wrong decisions. Information does not have to be deliberately falsified, it is also possible to distort it by passing it to many levels. This effect is easily seen in the "telephone" game children play. The "telephone" problem is amplified by the number of intermediary stages in information transfer and by unethical behavior (Fig. 7.7).

What solutions are available for the information problem?

1. **Open communication**

Firstly, it is a good idea not to prescribe a hierarchical reporting path, but rather to give the lower levels the possibility to skip hierarchical levels. This may result in conflicts of objectives. The task of a hierarchy with management levels consists in the information aggregation and selection and on the other hand in the delegation of leadership. The employee of a lower level will generally not be able to decide who needs what information. Rather, it can be assumed that much redundant information will be passed on to the wrong executives, resulting in inefficiencies. Upper control levels are overloaded with the additional processing of information. In addition, a manager who works two levels above the employee can assess the concrete work situation only with difficulty. The framework information is missing in order to process the transmitted information. In addition, the superordinate level will not want to be involved in leadership questions in order not to frustrate the leadership of the lower levels or undermine authority. This also makes it clear that a good working climate is a prerequisite for open communication. Without mutual trust, there will be no communication between the levels, as we will elaborate in more detail later. The dimension of these target conflicts will also depend on the nature of the company or the company area. In particular, the qualification of the employees at the lower levels will determine whether they can decide which information is relevant for the higher levels. From this point of view, open communication can be applied to areas of high qualification, such as research departments, business consultancy or financial services providers.

2. **Face-to-face talks of company management with randomly selected employees, independent of hierarchical levels**

Implementation problems of open communication apply only to bottom-up communication and not to top-down communication, which is why the top management levels occasionally update their information through a direct call to lower levels to check the inter-level information flow.

3. **More self-responsibility(decentralized management)**

From analyzing the organisation of ants in Sect. 5.6, we concluded that decentralized management of complex tasks, i.e. decision-making at lower levels, taking into account corporate objectives without the feedback of a higher authority, is possible. This presupposes that the employees, like the ants, have a corresponding imprint. These are the knowledge of the company's goals and the morality or attitude to ethically pursue corporate goals without control. Here, too, ethics play a decisive role.

According to a study of 150 management executives conducted by Roland Berger, a decentralized form of organization has the highest growth potential.[73] Decentralized management presupposes ethics among the employees, insofar as they have to assume responsibility. They must make decisions with an impact on the success of the company and the welfare of third parties, i.e. a balancing in the sense of an ethical stakeholder approach. This in turn requires an ethical personality and professional competence, which means that this approach cannot be applied in all areas of the company, though it has many advantages. The information problem presented above is eliminated because it is clear where the information for ethical weighing of options is available and responsibility is assigned to the place where decisions and information coincide.

4. **Fewer hierarchical levels**

The fewer hierarchical levels there are, the fewer conscious and unconscious information distortions exist. The goal of an organization should be a minimum of leadership, as the Lean Management approach has already expressed. Every leader has his own interests and strengthens the principal-agent problem in the company. Excessive managers weaken the employee's motivation by improper interventions, worsen the operating climate and reduce the acceptance of the company's income distribution.

5. **An ethical management**

An ethically-oriented corporate management tends to get more and more honest information from the employees because there is a trust base. An ethically-oriented

[73] See Bötzel, Stefan u.a. (2004), p. 8.

corporate management also includes an ethical employee selection and value mediation in the company.

Conclusion

First, it should be noted that an irresponsible corporate structure is not just a problem of ethics. If the responsibility is not clearly assigned, this means that the employees cannot be held accountable for wrong decisions. This is a negative incentive. Non- or faulty services will not be punished, resulting in a lack of management and thus a lower productivity. Furthermore, a lack of responsibility does not mean that you do not feel responsible. With a trained ethical awareness, the employee will ask himself what he can change positively and what consequences his actions and his non-action have. What is crucial is that the supervisors support him, so the company is ethically oriented.

Since such a self-critical employee can not be taken for granted, responsibilities must be clearly defined in the job descriptions. Responsibility trees help, as they assign product responsibility of the company to all employees involved in the production position. It is important that there are no gaps in responsibility or overlapping areas either, which could lead to misunderstandings among the employees regarding the division of action and responsibility. In order to clearly divide the tasks of the employees and thus also the responsibility, they have to be presented together with the company processes within the framework of quality management.

A basic problem is that the supervisor cannot know when there is important information at the lower level. The responsibility for the information transfer must therefore lie decentralized with the employee, who is the first to receive it. Information transfer must be a duty. Forced information transfer should be sanctioned.

Ultimately, hierarchical levels decrease efficiency because decisions are delayed and information is lost. Freedom rights and labor costs are high in the modern industrial areas, which means that with fewer hierarchies and more responsibility for the employees, not only could costs be saved, but also higher pay and greater scope for personal development would be possible.

It is an illusion that executives can control employees. The more complex the tasks become, the less is possible, since the employee always has an informational advantage on the executive. It is also difficult to make general statements about the set of hierarchical levels and the structure of the hierarchies, since the processes and tasks, and ultimately the qualifications of the employees in each industry are different. Companies should not only set up cost centers for executives and try to cut down the revenues of the subordinate employees, but also run trials without the hierarchy to show the added value and the tasks of leadership. In the banking sector, for example, decentralized activities, such as distribution, could be assigned to a personnel and information coordinator. The responsibility would then be clear for the employees who have direct customer contact and thus immediate information access. However, a holistic approach to decentralized management is required, as is the management approach of qualitative leadership which is presented later.

Summary
Good management practice is about developing a culture of trust. For this, supportive behavior is demanded, instead of a hierarchical dependency, as is the opening of information paths across the organization. Decision-making competencies should be delegated rather than centralized, combined with more self-control rather than external control.[74] The approach of the decentralized company organization means an optimization of decision units as modules, so that the disadvantages of a complex hierarchy are circumvented, but the individual at his level is not overwhelmed with decisions. The employee can directly intervene in the company process. In this way, elaborate decision-making processes become superfluous and the motivation of the employee in the company is increased.[75]

Comprehension Questions
1. How can hierarchies negatively affect productivity in a company?
2. How can hierarchies negatively affect ethics in a company?
3. What are some possibilities to avoid the negative effects of hierarchies?

7.2.2 Ombudspersons

The name Ombudsman comes from Sweden. The ombudsman serves as a contact, mediator and conciliator for the citizens and is intended to strengthen its position against the state offices. For example, he examines complaints about misuse of power or arbitrary decisions. In the company, he can perform a similar function. It serves as a neutral, institutionalized dialogue and access body. If he enjoys trust, he can settle conflicts and make external whistle blowing superfluous.[76] In order to maintain objectivity, it is a good idea to engage an external lawyer for this task. In this case, the term "trustworthy attorney" is recommended as a more suitable name. As an external lawyer, he is supposed to mediate between lawmakers and the company in the event of legal violations such as fraud, infidelity, bribery and other economic offenses. Compared to anonymous online systems, the ombudsman offers the advantage of personal contact, which – as practice shows – almost eliminates false information. Online systems are also less familiar with how to deal with the information. The Ombudsman has the role of a trusted person. On the one hand, it protects the identity of the complainant. On the other hand, the employees want to not only communicate their problems, but also advise them about the progress of the complaints process.[77]

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[74] See Steinmann, Horst/Löhr, Albert (1991), p. 120.

[75] See Reichwald, R./Möslein K. (1997), pp. 16.

[76] See Staffelbach, Bruno (1994), p. 328, Joussen, E. (2008), pp. 50 and Göbel, Elisabeth (2010), pp. 270.

[77] See Joussen, E. (2008), pp. 50 and http://ombudsmann.lexpert.de/products/products.htm and http://www.ombudsmann-strafrecht.de/fragen-antworten.html (Abfrage vom 22.08.2014).

The Ombuds Office makes it possible for employees on lower levels to bypass the hierarchy. It is best to demonstrate neutrality if the position is occupied externally. It is only when it is neutral and objective that it will be recognized by the employees and the company offices. However, it also needs the support of management, otherwise the recommendations will not be implemented and will be meaningless.

For stakeholders, for example, free hotlines can be created for complaints, which also include ethical issues (e.g. customer complaints).

7.2.3 Ethics Officers

Ethics officers perform the functions of a complaint office and an ombudsman. However, their scope also encompasses anticipation of ethical problems and conflicts, and proposals for solutions. The dialog function is thus expanded by an innovation, impulse and development function. An Ethics Officer in the USA is also responsible for implementing the ethical standards adopted in the company and for establishing or maintaining an ethical corporate culture.[78] The ethics officer can be supported by their own department, which is particularly appropriate for large corporations, where there is a network of ethics officers who are internationally distributed and need to be coordinated. For example, Siemens has set up the "Compliance Helpdesk and Monitoring" department in Germany, which provides information on immoral practices and maintains a hotline ("Tell us") and advises employees on ethical issues ("Ask us").[79]

7.2.4 Ethics Commission

In contrast to the aforementioned institutions, an ethics committee is not a permanent body and is made up of several people, which makes an even greater acceptance in the company possible. The people should be selected in such a way that all stakeholder groups of the company and possibly also other stakeholders (for example customers) are represented. A dialogue forum increases both acceptance and legitimacy and allows the company to use the commission as a forum for discussion.[80]

Classical tasks of the ethics committee are e.g.

[78] See, http://www.corporate-ethics.us/EO.htm and http://www.wisegeek.com/what-is-an-ethics-officer.htm (9.10.2012).

[79] See Göbel, Elisabeth (2010), p. 275.

[80] See Steinmann, Horst/Löhr, Albert (1991), p. 115 and Pech J.C. (2007), pp. 267.

– the preparation and development of the corporate image and setting penalties for non-compliance,
– ethical advice to management,
– develop solutions to ethical issues,
– external and internal ethics complaints as well as
– propose measures to promote an ethics culture within the company.[81]

Except for external and internal ethics complaint processing, these are all advisory functions that can be met by a body composed of employees and external stakeholders. In this way, an ethical stakeholder dialogue can be held within the Commission and thus an ethical consideration taking into account the external perception of stakeholders. In dealing with complaints, however, an ethics committee has the disadvantage that it is not a permanent organ in the company. The many different members of the commission can also lead to voting problems. This is why they should be supported by the internal ethics officers in handling complaints. In general, the ethics committee should be given the opportunity to inform itself directly about the business processes. For this, it is necessary for them to interview employees directly.

In general, the ethics committee has only an advisory and opinion-forming function. The executive powers lie with the management. But there is also another design option here. The ethics committee can assist the supervisory board or the owner in monitoring the management through a separate information function, thus reducing the principal agent problem. The ethics committee then no longer only advises the management, but also the supervisory board. The Supervisory Board represents the owners of the company in the control of the management and therefore the entire company. In the end, they ultimately contribute to ethical corporate responsibility as the highest organ of the organization.

7.2.5 Whistleblowing

How should an employee behave when supervisors order him to carry out an immoral act because it is supposed to be in the company's interest? Employees and executives are in a dilemma or loyalty conflict here.[82]

For the employee, it is easiest in this case to pursue the interests of the company, because he does not have to deal with sanctions and may even be rewarded. This behavior, however, is not ethically desirable because third parties are harmed. The employee cannot usually quit because he is dependent on his workplace and this is disproportionate power. Quitting would be a frightening behavior for other employees and would not change anything in the company policy. He could argue the case with the superiors and colleagues and appeal to moral values. However, this requires

[81] See Staffelbach, Bruno (1994), pp. 331 and Wittmann, Stephan (1994), p. 89.
[82] See Steinmann, Horst/Löhr, Albert (1991), pp. 152.

a lot of civil courage and is not necessarily successful, but is sometimes understood as an affront. As a rule, employees will avoid confrontation with the company and behave unethically as a result[83] In the long term, the company generally suffers from unethical behavior, as will be shown in the following examples:

– Customers should not be lied to about product characteristics and terms of contract: In the short term, a profitable sale is achieved, but in the long term the company loses a customer and its reputation.
– Balance sheets must not be falsified or bad corporate messages kept secret from the lenders and shareholders: In the short term, the company can ward off negative consequences, but usually no turnaround is achieved on this basis and the misconduct will accelerate the decline.
– Dependencies (for example from suppliers) should not be exploited: it is quite easy to depress the supplier's prices. However, if the supplier no longer has a profit margin, he will fail in the medium term or will lower the quality of his products and thereby deteriorate (for example, the GM/Opel strategy for the buyer Lopez[84]). In the long term this strategy leads to quality problems and a concentration of the suppliers, which makes a one-sided dependence into a mutual one.

If ethical violations are not in the interests of the company, it is important that an open corporate culture exist in which alleged violations and conflicts are addressed. The employees will not otherwise dare to reveal their ethical dilemmas and erroneously try to act in the interest of the company.

Since the company management cannot monitor the processes in the company, it often does not know about unethical behavior. In most cases an employee can turn to his or her superior and the latter will support him or her in the case of ethical action. However, if superiors are involved in the violations, they will try to keep the unethical incidents secret.

In addition, the public, i.e. the stakeholders and the economic system as a whole, are interested in ethical company behavior. Whistleblowing can also be extended to them.[85] Unethical behavior damages people and the system as a whole, as it leads to cost/benefit distortions. If the internal complaint channels of the company do not work or the company management covers up the unethical behavior, the employee can only turn to the public in order to achieve a change through public pressure. In order to tackle this problem, there is an organizational approach, so-called whistleblowing, which is the disclosure of unethical business practices to the corporate management or the public.[86]

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[83] See Göbel, Elisabeth (2010), p. 203.

[84] See Süddeutsche. de, 17.12.2010. http://www.sueddeutsche.de/wirtschaft/opel-lopez-und-die-boesen-folgen-1.810821

[85] See Annuscheit, Rainer (2009).

[86] A minority opinion also includes the internal display of unethical behavior by colleagues or other employees of the company in opposition to whistle blowing. See Leisinger, Klaus M. (1997), pp. 133.

In the following cases, employees turned to the public to stop an unethical behavior:

1. The vice president of the research department of the US tobacco company Brown & Williamson, who made public the fact that his company was secretly adding addictive ingredients to tobacco.[87]
2. In the run-up to the Challenger disaster, employees pointed to security shortcomings.[88]
3. Employees at Ford Pinto pointed out safety deficiencies.
4. The American Dan Gellert informed the public that the aircraft L-1011 of his employer Lockheed did not meet safety requirements.[89]

There are various criteria for whistleblowing. The criteria for awarding the Whistleblower Prize are cited by the Association of German Scientists. For whistleblowing, the following prerequisites must be fulfilled (definition):

- First, it must be a revealing wrongdoing.
- Secondly, the whistleblower must be able to sound an alarm by first trying to draw attention to the disgrace in the company. If nothing happens there, he goes public (going outside).
- Third, the whistleblower must show unselfish motives (serving the public interest).
- And fourth, he has to accept important disadvantages, such as threats to his position, his career or even his existence due to the revelation (risking retaliation).[90]

Whether or not a personal advantage is associated with whistleblowing is important for the ethical assessment. For example, the sale of Swiss tax CDs with the secret bank data of potential tax evaders is not motivated mainly by ethical reasons if 2.5 million euros is paid by German tax offices.[91] Rather, the whistleblower is expected to accept personal disadvantages in order to benefit the community or to calm its conscience, which is an extreme ethical requirement that recalls Kant, who expects a good attitude as well as self-sacrifice for a pure, optimal ethical action.

Whistleblowing is the conscious circumvention of the company hierarchy or corporate management. Whistleblowers are often perceived as informers, disloyal employees or tattletales, and are exposed to bullying or reprisals. The company is not responsible for the whistleblower, the company itself, or other stakeholders (such as vendor-dependent vendors). The consequences are drastic when the employee turns to the public, because this is always associated with company image. It is also not impossible that innocent employees will be harmed by whistleblowing

[87] See Maijca, Marin (2003).

[88] See Martin, Douglas (2012).

[89] See Leisinger, Klaus M. (1997), p. 134.

[90] See the criteria for awarding the Whistleblower Prize by the Vereinigung Deutscher Wissenschaftler (Association of German Scientists). http://www.vdw-ev.de/index.php/de-DE/?option=com_content&view=article&id=17 (retrieval 22.08.2014).

[91] See Pittroff, E. (2011), p. 9ff and Göbel, Elisabeth (2010), p. 206.

if, for example, an environmentally damaging product can no longer be manufactured and the employees have to be dismissed.

The whistleblower must therefore always weigh the possible outcomes. What are the consequences of his action, and who will be affected? Furthermore, it should only be an option on the basis of facts and after having exhausted all internal business opportunities. Open arguments and complaints are always preferable to whistleblowing. The facts should be assessed objectively, as emotional revenge feelings are counterproductive.

Because of the interest of the public in the discovery of unethical business behavior the whistleblower has been legally protected against bullying or dismissal in GB since 1999.[92] In Germany an employee is obliged to be loyal to his employer, and must first report criminal offenses, with the exception of serious crimes such as robbery and predatory blackmail. Only when this is unsuccessful is it allowed to go outside. If he infringes this regulation, a dismissal is justified under employment law.[93] Being ordered to do something is not an excuse. A superior who orders a crime is punishable, as is the employee who performs it. At best, there is a reduction in penalty if there was a strong dependency.[94]

Whistleblowing can also act as a principal witness regulation if the whistleblower is involved in the criminal offenses. In the case of UBS, the US Internal Revenue Service (IRS) decided to reward the informant Bradley Birkenfeld with $104 million for information on American tax evaders.[95] However, this has little to do with ethics.

Whistleblowing always shows that the official complaints and company controls or hierarchies have not worked. At the very least, trust in the whistleblowers is missing in their own company culture. Corporate culture is mainly characterized by management. A culture of "silence" and "looking away" is usually produced by the management. The creation of taboos that management wants to suppress, such as poor working conditions and safety standards, or poor product characteristics, is sanctioned by discriminating employees in the company processes. There is no risk communication. Such a culture promotes "betrayal," since it can be broken only by whistleblowing.[96]

The company can use the function of the whistleblower by appointing an independent contact person, creating a position directly under the management of the company. Messages should be official or anonymous and must always be excluded from reprisals. The whistleblowing office requires unlimited access authorization in the company in order to check the correctness of the messages or to collect evidence.

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[92] See Thurn, Valentin/Ott, Ursula (2001), p. 104.

[93] See http://www.spiegel.de/karriere/berufsleben/geaechtete-whistleblower-die-denunzianten-vom-dienst-a-765414.html

[94] http://www.fiskalbetrug.de (30.09.2013).

[95] See http://www.washingtonpost.com/business/economy/ubs-whistleblower-awarded-104m-by-irs-for-helping-in-swiss-bank-probe/2012/09/11/1a7232a2-fc28-11e1-b153-218509a954e1_story.html

[96] See Rhode-Liebenau, Björn (2005), pp. 37.

The company management may be exempted from this. The internal company whistle-blowing cases are not public, which is a major advantage for the company. The reputation of the company will not be damaged and punitive payments may be avoided.

Summary
Prevention can be achieved through ethics seminars, guidelines, ethical promotion and remuneration guidelines, direct contact between hierarchy levels, thus also the company management with the basis and ultimately through the correct selection of the managers and employees. The decisive factor is corporate culture, which should promote ethical behavior instead of suppressing it. Ultimately, it must be possible to place information and in particular complaints past the hierarchy. There should be ombudsmen for complaints about supervisors.

The presented organizational measures support ethics within the company. However, the decisive factor is an all-embracing ethical concept, which is supported by the entire company and is internalized by the employees, especially by the management. Of course, the establishment of ethics and ethics instruments is an effective PR instrument. If it remains, however, it acts counterproductively.

Comprehension Questions
1. Do you consider complaints offices in companies important? Give reasons for your opinion.
2. What types of complaint offices are there? Describe their advantages and disadvantages.
3. Name the four criteria for whistleblowing.
4. How can whistleblowing come about?

What Follows Why?
It has been shown that ethical behavior increases productivity in the company. The following is about ethics in human resources management. The management and selection of personnel directly influences the corporate culture and is therefore the most important instrument for the ethical conduct of the company.

7.3 Leadership Ethics

Leadership in a company is defined as a goal-oriented design, steering and development of the company (definition). This includes corporate governance as the company's organizational structure and management, in particular the personnel management. Guidance is also understood as "the goal-oriented behavioral influencing of persons by means of communication processes" and related to the operation, "the behavioral influencing of the employees by the superiors."[97]

[97] Hey, Dieter/Schröter, Armin (1985), p. 31. Or "Leadership is the accomplishment of a goal through the direction of human assistants." Prentice, W.C.H. (2004), p. 102.

In the following, we will use the Case Study of Enron to elaborate the requirements for optimal corporate management.

7.3.1 Case Study of Enron

Group Work Enron

Read the case Enron described in Sect. 4.1 and discuss the reasons for the bankruptcy of Enron in your group. How could Enron rise to the top ten US companies and then collapse?

7.3.2 Weaknesses of Corporate Governance

7.3.2.1 From Entrepreneur to Manager

If we continue to look for causes behind the business crises described, mistakes made by managers seem to be a central factor. What is the function of managers in a company? What are their special attributes? Let us start historically and ask how we arrived at companies run by managers. Excepting agricultural operations, companies only came into being within the framework of industrialization. First the productive combination of human and machine as a result of progress in methods of production made the distribution of labor in larger groups lucrative. The first industrial companies of any importance were porcelain and fabric manufacturers in England, France and Germany in the seventeenth and eighteenth centuries. The company as an organizational form was created, which would come to dominate national economic value creation over the following decades and centuries as technical progress advanced. The industrial revolution permanently changed the requirements of human cohabitation. The world was no longer the same and each new step of technical progress again changed the general framework for the economy, and thus for society. The globalization currently discussed is itself a consequence of the progress made in transportation and communication technologies. Globalization has existed at least since the invention of the sea-faring vessel. The importance of capital grew with technological progress. For the increasingly complex machines, increasingly large shares of the domestic product had to be funneled to investment. The organizational form and social construction of a company also became larger and more complex. Whereas a farmer could cultivate a field himself with a plow, now many people became dependent on mutual cooperation in order to realize value creation together.

How were companies created? How were humans and machines brought together into a productive whole? The famous economist Schumpeter offers a qualitative explanation for this phenomenon.[98] According to Schumpeter, there must first always be an entrepreneur. An entrepreneur is no ordinary person, but is a gambler and a daredevil. The founder of a company, the so-called pioneer entrepreneur, plays his luck for the possible riches and dares to make the first step in realizing his idea, which is generally an innovation. These are often engineers, such as Edison with his light bulb, who founded General Electric, but it can also be an innovative process such as assembly-line production from Henry Ford, new organizational forms, the development of a market or something similar. All of these ideas carry the promise of large profits in the process of value creation, in other words added value for the pioneer entrepreneur. They are dispersed across the entire national economy later on, when the innovations and ideas have been established and copied by others who try to get pioneer profits in competition by forcing prices down. The advantages to be gained from the products are then distributed almost exclusively among the consumers. The pioneer entrepreneurs carry the risk of failure on themselves, including the capital that they invested to see their idea realized. The attractive profits and a certain thrill in the risk are just one aspect to explain why risks are taken for an enterprise. Otherwise entrepreneurs would be no different from gamblers. They are designers, changers, who must cut new paths with their idea. There is a great deal that goes into the implementation of an idea in an enterprise.

The entrepreneur must be convinced of his idea and have an iron will to implement it. This conviction often borders on mania; it gives him the energy to get things moving again and again, and to overcome obstacles until his idea has been realized. Schumpeter talks of a dynamic entrepreneur. This usually goes so far that the entrepreneur makes the idea into his life's purpose. He is so convinced of its importance, that the idea and the person become one, which can border on an obsession. He finds the implementation of the idea in the enterprise creative and meaningful self-realization, a creative process for something entirely new. He is prepared to risk his existence and security for it. This classical entrepreneur has access to neither venture capitalists nor stock markets. He is usually forced to borrow the capital and be personally responsible for the debt. Schumpeter thus identifies an additional requirement for the implementation of the enterprise. The entrepreneur must find a dynamic and risk-friendly banker who sees the potential of his idea and makes the necessary capital available to him.

So, to sum up, an entrepreneur is historically something special and something positive. He is not only something of a genius, he is a mover and a shaker and someone willing to dare to actively implement an idea. He helps the national economy by implementing an innovation and creates value through the productive combination of humans and machines. He wants to see his idea become a reality and risks his own existence for it. Of course he wants to be rewarded for his efforts. To get rich is often not the main motivation, but comes after the self-realization. This idealized image of an entrepreneur is basically altruistic. He apparently sacrifices himself in order to create jobs and welfare for everyone. He should therefore be honored and admired by society. This image does not correspond to today's reality, in which

[98] See Schumpeter, Joseph Alois (1911).

society no longer has a picture of the self-sacrificing entrepreneur, but that of the greedy manager.

A manager is not an entrepreneur. The job description of an entrepreneur has changed over the years. Pioneer and founding entrepreneurs are the exception today. There are still innovations made now and then, but they are usually made within existing companies. The picture painted above of the company liable for itself is rarely the case anymore. The introduction of joint stock companies has fundamentally changed the distribution of risk. In order to finance innovation potential, and thus to be able to use it, the stock companies were created in addition to private companies to be a collection point for capital and limit the risk liability. Only the capital used is the liability. The entrepreneur no longer has to wager his person and existence for his idea. Even start-ups finance their growth and innovation with venture capital from the corresponding stock markets. A new breed of manager was created. He became an employee of the investors, an agent of the principals, which brought new problems.

The role of the manager includes other interests and motivations just as the capital-providing market has other legalities. These legalities can make moral or ethical behavior, and thus efficient management, more difficult. We will examine this in detail in the following chapter.

7.3.2.2 The Principal-Agent Problem

There are many theories on managers. The old Stuart Theory considers managers idealistically as "honorable wealth builders." Neoclassical theory presupposes maximization of benefit, but does not differentiate between company owner and manager. If entrepreneurs as founder and owner no longer head enterprises, but instead the owners entrust third parties with the tasks of company management and thus separate these roles, the interests behind each role are also separated. Anyone who has ever delegated an important task to a third person can understand this, as they became dependent on the other person's performance and reliability. This has advantages and disadvantages. If the agent, that is the employed third person, is better qualified for the task than the principal, that is the owner or capital provider, then the task delegation is advantageous for both parties. The principal is always faced with the problem however, that he has to rely on the agent. The principal-agent issue can be expressed in the saying "never trust anybody but yourself." Economic science addressed this problem as early as Adam Smith, and has taken it up in the Principal Agent Theory in the last few decades as joint-stock companies have increased in importance.[99]

[99] Ross is considered to be the founder of the Agency Theory. See Ross, Stephen A. (1973a, b), p. 134 and Novak, Eric (1997a, b), p. 22. Jensen, Michael C./Meckling, William H. (1976a, b), p. 348. The foundations can already be found in Adam Smith's "Wealth of Nations …", See Madrian, Jens Peter (1998), p. 69.

The Principal-Agent Theory first dealt with this divergence, although it continued to assume consistent rational benefit maximization. According to this, if taken ad absurdum, it would be the goal of the manager, within the legal framework and using the least amount of labor and personal sacrifice, to get the most out of the company he has been entrusted with for himself, thus damaging the company. The conflict of interests between principal and agent are emphasized in the Principal-Agent Theory. In reality, managers are generally between these two extremes, being neither selfless, self-sacrificing pawns of the capital provider, nor a purely benefit-maximizing parasite. The capital provider must be aware of the possible conflict of interest however, and calculate for the extremes.

With diverging interests, the principal-agent theory differentiates between the so-called moral hazard and risk-shifting problems. Moral hazard describes the incentives of the agent that would be damaging to the principal, such as hiding profits from the principal in order to show them in hard times as successes. The agent engages in risk-shifting when he secures the enterprise risk at the cost of the principal, for example by holding back dividend payments for the principal as profit retention. The agent could also increase his benefits at the cost of the principal through indirect benefits, which we might imagine as expensive business trips, office spaces and company cars. Of course the intrinsic human interests and needs are a part of everything we do and should not be underestimated. The manager wants power, influence and recognition. He can reach this goal by increasing sales e.g. at the cost of profitability and enterprise security. This would also be possible through take-overs, in which he could strengthen his image as a conqueror. On the whole, the principal-agent theory determines various agency costs that arise from the separation of enterprise owner and manager. First there are the bonding costs, which the principal must pay in order to assure that the agents act in conformance with their interests. Then he must remain informed and intervene in the case of deviant behavior, to force the agents to adjust their behavior. The remaining residual costs come from the fact that he will never succeed in getting the agents one hundred percent in line with his interests.

When implementing his interests, the principal is at a disadvantage from an asymmetry of information. The principal-agent theory differentiates between hidden characteristics, hidden information and hidden action. Hidden characteristics are understood to be the personal characteristics of the agent that are not known by the principal upon entering a contractual relationship despite certificates, such as the actual level of qualification, integrity, work habits and loyalty. Bringing in external managers carries a large risk of false estimations (hidden characteristics). Managers may be able to prove their success in other companies, but it may be very difficult for the principal (employer) to judge the truth behind such assertions. The market for managers is not transparent for the seeking employer, nor is the actual good itself, the personnel. Hiring an external employee is thus quite risky and can only be recommended if there is no one comparable from inside the enterprise available, or if knowledge from outside the company, to which there would otherwise be no access, can be acquired.

Headhunters also help little to overcome asymmetric information, as they are interested in placing their candidate well in order to earn the higher salary through the placement commission. In turn, a manager can exploit the asymmetric information to his advantage through frequent job changes. If he succeeds in presenting himself better than he really is, he can improve on every change. If his lack of suitability in the company increases after he has established his position, he can leave. Often, the new employer tolerates the weaknesses of the manager. In principle, however, the manager who has hired him is not interested in revealing his decision to make a mistake as long as the weaknesses of the employee do not pose a personal disadvantage for him.

Hidden information is the informational deficit that the principal has when controlling the actions of the agent. He simply does not know what information is behind the actions of the agent. Hidden action is then the inability of the principal to evaluate the effectiveness of an agent's actions after the fact. The principal may know the results of the action, but not the framework in which the action took place, in other words all environmental conditions at the time of the action. He thus does not know if the success or failure is due to external factors for which the manager is not responsible, or due to the performance of management.[100] It is easy for the manager to blame his failure on external factors such as a recession, reductions in demand, bad weather, preliminary product shortage etc.

The control costs for the principal are directly related to the expected returns from his share of the capital, as information and implementation costs increase with the size of the company. If the agency costs are less than the residual costs, the principal will not interfere. Herein lies a fundamental problem of the mutual stock corporations. Control is only possible, if at all, via the supervisory board, since the small investors or capital providers abroad are not present at the shareholder's meeting due to time and travel expenses disproportional to their stock share. In such cases control through the supervisory board is impossible. On the other hand, minority shareholders have a disproportionately high level of power at shareholder's meetings due to the small number of those entitled to vote who are actually present. From this background it is apparent why the investors in Enron and the investment banks within the framework of the subprime crisis, were unable to control the managers.

The control of the managers by the owners is made more difficult by the close linkage of supervisory boards, board members and politics, especially in Germany and Switzerland. In the literature one speaks of a consensus society, which arises from these personal relationships and which can be blocked against changes.[101]

The disproportionate development of salaries can thus also be attributed to the lack of control of the company's management. Why should an immorally-minded board of directors omit self-enrichment if they have nothing to fear?

[100] See Madrian, Jens Peter (1998), p. 70.

[101] See Schieffer, Alexander (1998), p. 296.

7.3.3 Incentives, Risk and Compensation Schemes

7.3.3.1 Experimental Evidence on the Importance of Risk Adequate Compensation

Since the Enron, Worldcom and the financial crisis, compensation for bank managers and managers in other public companies have come under intense scrutiny. Compensation has been held responsible for encouraging excess risk-taking, particularly within the financial system. It has been asserted that bonus compensation schemes have caused asymmetries in the treatment of gains and losses, which can lead to excessively risky behavior. The purpose of this chapter is to test this hypothesis.[102] Do unilaterally constructed incentive schemes encourage undue risk-taking? This question is examined with a behavioral experiment using the game roulette. It is used to analyze how unilateral compensation affects risk behavior.

Related Literature

According to principal agent theory (Ross 1973a, b; Jensen and Meckling 1976; Nowak 1997a, b) correlating a manager's compensation with either their performance or that of the firm promotes better incentive alignment and leads to higher motivation and thus stronger company values. However, there is an asymmetric imbalance between the term, magnitude and probability of gains and losses in common compensation schemes. Short-term results are rewarded even when these results are later reversed. This encourages risk taking by the employees – agents – at the cost of the company – the principal. The agents undertake actions that generate a high probability of gains in the short-term, while the risk of a larger loss in the longer-term is not taken into consideration, causing the principle to bear all of the long-term risk. A substantial body of literature has emerged to test the relationship between manager compensation and manager behavior and performance.

Figures of the Office of the New York State Comptroller show that bonuses in Wall Street financial institutions continued to register large positive numbers in 2007 and 2008, even while the banks suffered large losses (Sharma 2012). Surveys by the Financial Stability Forum (2009) showed that over 80% of financial market participants and experts believe that compensation practices played a role in promoting the accumulation of risks that led to the financial crisis. Cuomo (2009) shows that bonuses and overall compensation did not vary significantly even though profits diminished during the financial crisis. Cai et al. (2010) studied the pay structures of banking executives before the financial crisis. They found some problematic practices (such as too much bonus and stock-related compensation). These practices might have encouraged "short-termism" and excessive risk-taking.

Agarwal and Ben-David (2011) results show that the explosion in mortgage volume during the crisis and the deterioration of underwriting standards can be partly

[102] See Conrad, Christian A. (2015): Incentives, Risk and Compensation Schemes: Experimental Evidence on the Importance of Risk Adequate Compensation, in: Applied Economics and Finance, Vol. 2, No. 2; November 2015, p. 50–55.

attributed to the incentives of loan officers. They studied a controlled experiment conducted by a large bank. The compensation scheme of loan officers was changed from fixed salary to commission-based compensation. Loan officers were 19% more likely to accept loan applications, approved loan amounts larger by 23%, and the loans were 28% more likely to default. The increase in default occurred primarily within the population of loans that would not have been accepted in the absence of commission-based compensation.

However, Gregg et al. (2012) found that the cash-plus-bonus pay-performance sensitivity of financial firms is not significantly higher than in other sectors and concluded that it is unlikely that incentive structures could be held responsible for inducing bank executives to focus on short-term profits. This would mean that we are facing a general compensation problem.

Cooper et al. (2014) found evidence that industry and size-adjusted CEO pay is negatively related to future shareholder wealth changes for periods up to 5 years after payment. Sun reviewed the early executive compensation studies, bonus plan maximization hypotheses and equity-based compensation. Use of opportunistic management incentives encourage earnings management based on executive compensation for contracts is promoted when earnings management is driven by opportunistic management incentives. He shows that firms pay a price and its negative impact on shareholders is economically significant (Sun 2012).

Schotter and Weigelt (1992) use four different compensation schemes to demonstrate that a compensation scheme that induces behavior consistent with lower discount rates is a necessary condition for reconciling divergent time preferences between principals and agents, and that subjects become more myopic in their investment decisions if compensation contracts are incorrectly structured.

Colesa et al. (2006) found that higher sensitivity of CEO wealth to stock volatility encourages riskier policy choices, including relatively more investment in R&D, less investment in PPE, more focus, and higher leverage. They also provide empirical evidence of a strong causal relation between managerial compensation and investment policy, debt policy, and firm risk. Cheating is also influenced by compensation schemes. Gilla et al. (2013) show that exposing workers to a compensation scheme based on random bonuses makes them cheat more but has no effect on their productivity.

Andersson et al. (2013) studied risk-taking on behalf of others in an experiment. The decision makers were facing high-powered incentives to increase the risk on behalf of others through hedged compensation contracts or with tournament incentives. The decision-makers responded strongly to incentives that result in an increased risk-exposure for others. There have also been experimental studies concerning the binary choice task and the study concerning the binary double gamble to explore the predictive validity of dispositional traits and affective states in decision making under risk and uncertainty (Papaeconomou 2012).

This chapter provides a simple incentive-based experiment regarding unilateral bonus compensation schemes based on the game roulette which can be easily repeated with the students. There have been several experiments with roulette but with the objective to scrutinize the gambling behavior (Rubio; Hernández and

Santacreu (n.d)) and guessing tendencies (Rubio et al. 2010). The following experiment simulates most common short-term bonus compensation schemes without accountability. They were also the dominating compensation schemes before and during the financial crisis.

Experimental Design Roulette

The purpose of this chapter is to test the hypothesis that unilaterally constructed incentive schemes encourage excess risk-taking. The methodology is to simulate decision- making under asymmetric incentive structures. Therefore an experimental environment similar to the compensation schemes had to be constructed. Roulette has the advantage of clearly demonstrating the probabilities for gains and losses. In the game Roulette the probability of losses is compensated with higher payouts (apart from zero). A higher risk has an equivalent higher payout. In order to simulate behavior with different incentive and risk structures, decision-makers have to be exposed to different remuneration schemes, which is why there were game rounds with different considerations of gains and losses.

Game 5: Roulette

The experiment is started with symmetrical incentive structures. Round A and B have identical incentive structures. Round A serves as a control round for B. Finally in round C a unilateral consideration of the profits takes place and the changes in the betting behavior are recorded. An indicator for higher risk-taking would be a higher capital set even though the winning probability stayed the same.

In round A, the students are able to play Roulette with an initial play capital of €1000. Losses and gains are credited with 100%. The students are asked to check each other's calculations after each game.

In the round B the gambling losses and gains are counted each with 50% and are added to the initial capital of €1000. Thus there were still no conflicting interests and no asymmetries in the treatment of gains and losses. Round B therefore has identical incentive structures as round A. So A is able to serve as a control group for B.

In round C a unilateral consideration of the profits takes place. The set capital is not deducted, if the roulette bet is wrong. Conversely, the payout is credited with 50%, and added to the €1000 of initial capital. The results of the rounds B and C are added, starting from an initial capital of €1000 each and the player with the highest result is rewarded with €10 real money. For this game we chose real money to have a stronger link to compensation in real life. The rules are explained to the students before starting the experiment.

Round C thus corresponds to the unilateral performance-based remuneration of the common bonus-based compensation schemes. Loss and profit incentives are not equally distributed. Losses are borne by the companies and profits are rewarded with bonuses. This simple experiment shows clear results.

Results

The experiment was conducted with 69 students from different Business Bachelor and Master courses at the University of Applied Science HTW at Saarbrücken.[103] The students played 3 rounds Roulette (A, B and C), each with three games. They could bet on red or black, on one of the three thirds of the 36 numbers or on one number. The winning number and color was determined by the roulette wheel. If it was zero, the game was repeated and not registered. The payouts were distributed according to the probability of winning (×2, ×3, ×36) and accumulated in each round.

In round C, the sum of the average capital set rose from €1361.88 in round B to € 3899.28, by 186%. The highest possible profit (calculated as the product of the set capital and the possible payout) in all three games rose to €30,000.72 (see Figs. 1 and 2).

If you set the maximal possible gain in relation to set capital as a risk measurement indicator, the willingness to take risks increased from 5.05 to 7.69 (see Table 1). The significantly higher standard deviation in round C shows that some players were more willing to take risks than the average (see Figs. 7.8, 7.9, 7.10, 7.11 and 7.12).

Conclusion

The experiment showed that unilaterally constructed incentive schemes encourage excess risk-taking. This would indicate that common bonus-based compensation schemes are not a good idea and in face enhance risk because of the asymmetries in the treatment of gains and losses. In most cases compensation can only decrease down to the base salary while gains from bonuses can be limitless. Short-term results are rewarded even when these results are subsequently reversed. This encourages risk-taking by the employees (agents) at the cost of the company (the principal). They undertake actions that generate a high probability of gains in the short-term while the risk of a larger loss in the longer-term is not taken into consideration, thus becoming a liability to the principal. This does not align with the basic

	Round A	Round B	Round C
Average set capital	€1,252.63	€1,361.88	€3,899.28
Average maximal possible gain	€5,946.83	€6,874.49	€30,000.72
Risk as max. possible gain/set capital	4.75	5.05	7.69
Standard deviation average set capital	€779.65	€650.32	€2,408.89
Standard deviation maximal possible gain	€634.21	€9,687.06	€31,585.46

Fig. 7.8 Statistical data

[103] See Conrad, Christian A. (2015).

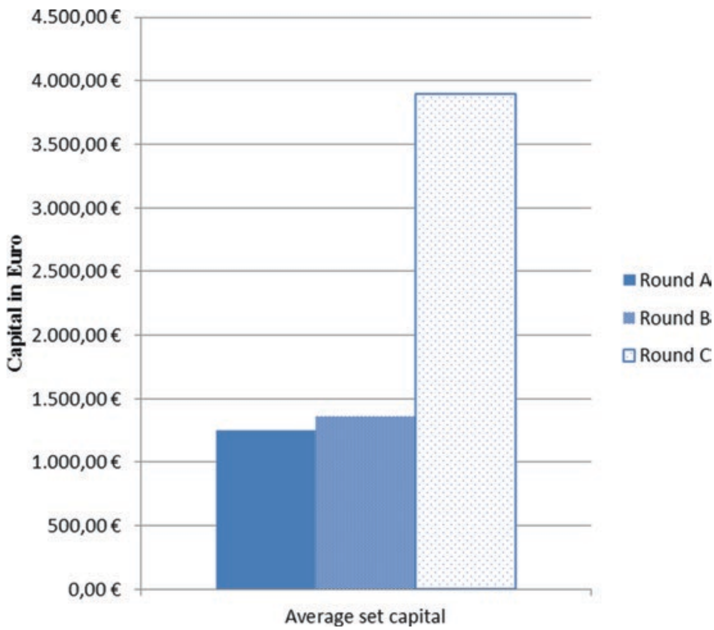

Fig. 7.9 Set capital

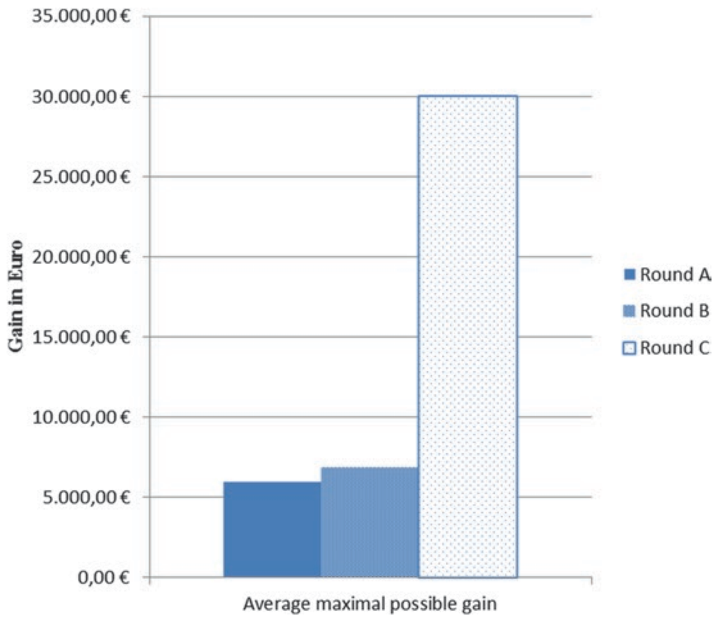

Fig. 7.10 Maximum possible gain

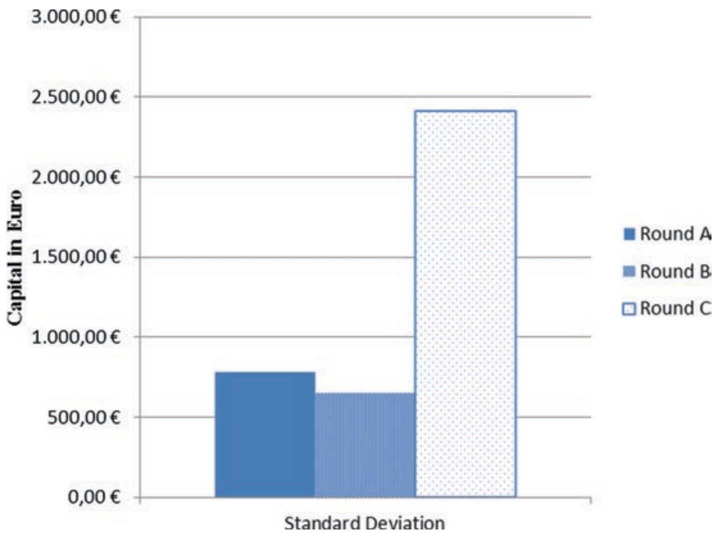

Fig. 7.11 Standard deviation set capital

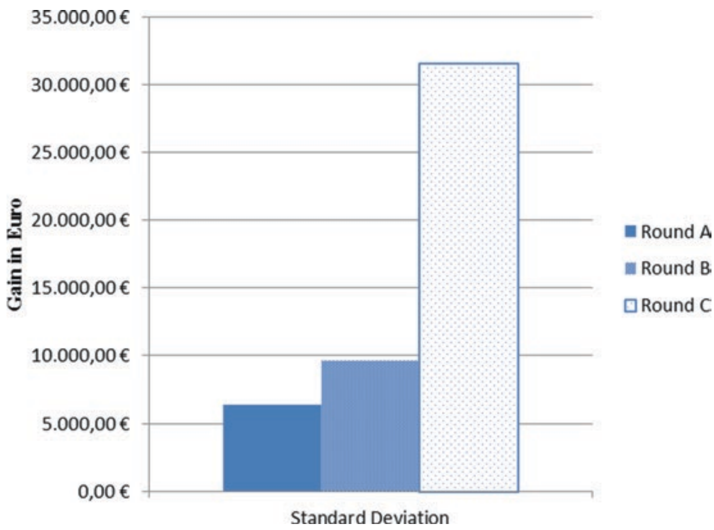

Fig. 7.12 Standard deviation maximum possible gain

idea of principal-agent theory. Of course a connection between a manager's compensation and a firm or manager's performance will promote better incentive alignment and lead to higher motivation, which increases firm value, but only if losses and profits are remunerated symmetrically.

The existing asymmetries of bonus compensation schemes have led to a divergence of interests between employees on the one hand and the health of financial institutions and other companies at large on the other hand. Compensation packages for CEO's and other managers have gotten out of control. Remuneration and bonuses depend on short-term profitability, which increases share prices in the short-term, but not the long-term health of the company. In the financial system, investment managers increased the risks for their employer by buying highly profitable but risky assets and were rewarded with high bonuses which led to the financial crisis in the long term. In addition, the review of research literature showed that cheating is promoted by high and unilateral variable compensations. CEOs have incentives to manipulate earnings if executive compensation is strongly linked to performance. Opportunistic earnings management behavior has been detected.

Risk adequate compensation is therefore an important prerequisite for good performance in all risk-handling professions. Without accountability variable compensation schemes become unilateral bonus maximation schemes with negative effects for the company and the principal. It means risking other people's money which will generally be abused (moral hazards) (Andersson et al. 2013).

7.3.3.2 Stock Options and Bonuses as Unethical Incentives for Company Management

What solutions are offered to overcome the principal-agent issue? The most obvious answer is to involve the agent in a share of the principal's success of the principal. Success-based bonuses or stock options are also called into question here. Stock options make it possible to share in a company at a set price for a predetermined length of time. Stock options are thus offered as a solution and such an approach provides a suitable incentive with which to get the managers (agents) to act in the interest of the shareholders (principals). When managers maximize their stock options they are also maximizing the shareholder value. With the increasing attention on shareholder orientation and the principle-agent issue in public, more and more companies are introducing stock options. Enron also used stock options. Interests seemed to be harmonized with the stock option. In practice however, stock options are a reflection of the unbalanced power distribution between stockholders and management, which has made them somewhat ridiculous. The options are usually given based on the current level of stock prices, which means managers do not have to do more than keep the status quo in order to take just the additional value created by the stocks to adjust for inflation. General movements in investments propitious for stocks increase the value of the options, which explains the exorbitant profit increases of the 100 largest US companies (excluding banks) by around 200%, in particular with more advantageous accounting regulations. In this time period there was a recession, while profits only increased by 3% in the growth phase from 1995 to 2000.[104] The value of the stock options held by ex-Daimler Head

[104] See Wirtschaftswoche dated April 23, 2007, no. 17, p. 113.

Schrempp in 2007 actually increased by about €50 million, even though the rate for Daimler stocks in his time in office fell from around €100 to around €50. At times the value of Daimler stocks was just €25.[105]

If there is to be a motivation for exceptional performance, it would have been better to select a basic price below the current price level, or at least distribute the options in relation to the value development of the average stock index and the respective company branch, thus setting a benchmark comparison. The manager would then be paid only for the above-average development of the branch. As it is, he gets rewarded for many things that he does not influence, and never has to pay, which makes the options in the end just additional wages.

The negative incentive is intensified by the generally very short look-up period. If the manager maximizes his benefits assuming this constellation, he will do everything possible to cause a short-term increase in stock prices. If he is successful, and achieves several million in the short-term through the sale of his stock options, the long-term development of the company is no longer important to him, especially if he can leave the company with his millions in profit from the short-term increase.[106] This is why world famous investment manager Warren Buffet considers the stock option plans to be the cause of incredibly overpaid CEOs.[107] For Sean Harrigan, head of the world's largest pension fund Calpers, the enormous increase in wages for top managers is also due to the professional salary consultants who can expect contracts from the top management at the same time (especially auditors).[108]

Be that as it may, the introduction of stock options to overcome the principal-agent issue has not only created a completely new incentive structure, but has completely distorted the internal distribution of enterprise incomes. If the difference between the salary of a worker and a top manager in 1980 was 40 times more, it was about 530 times more in 2001.[109] In the time period of 1990–2004 the annual salary of an average US worker was $27,000, which the average salary of US CEOs went from $2.82 million to $11.8 million.[110] The extreme increase in management salaries took place in the USA first. In the meanwhile, however, managers all over the world point to the USA when demanding higher salaries, and insist that this is the international standard. Even in the US the unequal salaries have become heavily criticized.[111]

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[105] See Berliner Zeitung dated June 05, 2007, p. 11.

[106] See Utzig, Siegfried (2002), pp. 595.

[107] See Utzig, Siegfried (2002), pp. 595.

[108] See Handelsblatt dated November 08, 2004, p. 2.

[109] See Schwarz, Gunter Christian/Holland, Björn (2002), p. 1665. Schwarz and Holland identify a ratio of 80:1 between top management and worker salaries in the 1980s as the reference point for salary increases. Sean Harrigan, Head of the world's largest pension fund Calpers uses 40:1. See Handelsblatt dated November 08, 2004, p. 2.

[110] See Die Welt, dated January 16, 2006, p. 16.

[111] See Handelsblatt dated November 08, 2004, p. 2 and Die Welt, vom 19.01.06, p. 16.

Stock options are an important incentive instrument in harmonizing the interests of managers and stockholders. They must be designed in such a way however, that only effective, thus successful, efforts are rewarded and the look-up period extends beyond the time that the manager is at the company. Otherwise stock options can have a negative effect on the long-term shareholder value due to the informational advantage of the manager. As the example of Enron illustrates, there are many possibilities to increase short-term shareholder value at the cost of the long-term value. Focusing on the short-term shareholder value, and thus the company success, was also a cause behind the stock market bubble of the 1990s and the subsequent crash from to the willingness to take high risks. This dangerous effect is increased even more by focusing on the shareholder value approach, as we will show.

Too large of a share for the manager in the stock capital of a company can cause a manager to undervalue being employed long term in the company. The manager is more likely to maximize his benefits by increasing the stock price in the short term in order to make his stock profits. He is then "rich" and can kick back and relax. The manager finds support in his planning of this kind of "business" from the insider issue, which is often underestimated, as we can clearly see in the case of Enron. The CEO and other managers in the company are the first to know if the orders received are unable to meet the published growth prognoses either in volume or in yields, if liquidity is short or claims are no longer valuable – not to mention the creative bookkeeping they do themselves. The manager can thus always sell their overvalued stock to the stockholders with less information who will be gullible, which is in fact fraud.

Many countries consider the burden of proof in such a case to be on the principals, which makes no sense based on the informational asymmetry. It would make much more sense to assume the managers are informed about the internal figures. The burden of proof of innocence if a manager permanently enriches himself at the cost of stockholders should be on the manager. In the USA at least, according to the rules of the 10b-5 Security Exchange Act, fraudulent statements with an effect on the price of stocks can be prosecuted in criminal and civil court.[112] In other countries the lawmakers and courts are apparently simply overwhelmed. For example, investors in the German enterprise EM TV had to prove that they bought their stocks due to the false ad hoc announcement and thus suffered damages. The company had falsely entered sales with children's shows and Formula1. As a result the company suffered loses in 2000 instead of the profit they had announced.[113] It is incomprehensible that top-paid managers and owners are not prosecuted by the justice system when they make false reports, from which they have profited. If the managers erred the reports should have at least been corrected by the managers in due course. Meanwhile, the managers can bank on the 3-year statue of limitations. Three years have never yet been sufficient for lawmakers and courts to reach and implement an effective judgment. In light of all this, it is no wonder that stocks still have a shad-

[112] See Handelsblatt dated October 19, 2004, p. 29.

[113] See Handelsblatt dated May 26/27/28, 2006, p. 26.

owy existence in Germany. The broad public is still put off by the rules of the capital market.

How can the effects of the principle-agent issue be reduced? Stock options are only somewhat suitable as a solution, and if they are to be applied, they must be organized differently. Stock options should motivate the managers to act the interest of the company. If they are incorrectly administered they only increase the opportunities of the manager at the costs of the opportunities for the principal while increasing the principal's risks. Correctly conceived, they would create the same opportunity/risk distribution for both parties. In contrast to the manager, the shareholder not only enjoys the increased value of the company, but also carries a loss of value. He is liable via his capital.

If the interests of shareholders and managers (principal and agents) are to be in harmony with one another, the manager may not only profit from a positive company development, but must be held responsible for a negative development. Otherwise the moral hazard problem comes into play. The manager is rewarded when he behaves immorally, touching up balance sheets and generally trying to achieve short-term success without considering the long-term company development.

There are many ways for the manager to manipulate success. For example, a CEO can devaluate the stock assets or create exaggerated reserves when he takes on the position, and blame this on his predecessor in order to then revalue the positions and claim it as a success. A one-sided and short-term inclusion in the opportunities for the manager generally encourages their willingness to take risks and give the long-term needs and risks of the company a lower priority. In addition, when one considers that the shareholder (principal) takes on a large risk when employing the company managers (agents), since he does know the manager's personality structure and qualifications (hidden characteristics), the responsibility of the manager is particularly important for the shareholder. In the end, the shareholder is always dependent trusting his managers because he can control their actions only to a limited extent, as we have shown. The more he can trust him, the less he has to try and control him, which reduces the costs for the shareholder and thus increases the returns on this capital investment. There is also a reduced risk of failure, which increases the expected value of the capital returns. Both will increase readiness to invest in the company. The shareholder can only trust the manager when the latter behaves morally. Morality is therefore particularly important for economic development.

Properly designed, the managers' incentives would have to create the same chances of risk distribution as the principal. In contrast to the manager, the shareholder not only participates in the value growth of the company, but also in the decline in value. He is liable with his capital. In order to establish a harmony of interests between the shareholder and the manager (the agent and his principal), the manager must not only profit from the positive course of the company, but must also be held liable for a negative development. Otherwise, disincentives (moral hazard problems) arise. The manager is rewarded if he behaves immorally, ie hears balance sheets and generally tries to show short-term success without consideration for long-term company development.

In order to align the long-term interests of companies and managers, stock options should only be given to the managers over the long term, as long as the company success is also increased by the manager over the long term. An appropriate index to use for cash flow would be modified long-term total capital profitability, in relation to the branch average.

Modified total Capital Profitability in percent (MCP) = (cash flow/balance sheet total) × 100

This index has many weaknesses as well, however. For example, it takes neither the financing structure into consideration, nor the necessary investments due to the focus on cash flow. This provides an incentive not to invest, since it would reduce the MCP. These disadvantages would be compensated by the long-term perspective. Exceeding the long-term above-average modified total capital profitability, of the branch, is the basis for a performance-oriented remuneration. This means that compensation is paid retrospectively at the MCP average of the previous 5 years and only if the company developed better than the sector as a whole. In addition, its greater advantage is its simplicity, which qualifies it very well as an external control measurement.

We have thus determined that stock options can cause lasting disincentives in managers (moral hazard issue) if the opportunity and risk distribution between principal and agent is not balanced and if the manager does not behave morally on principle. The same applies for success-based compensation, if for the short-term the manager is not put in the position to retire after only a few years and evade accountability. We will remember. By repackaging US mortgages as investment products, bankers were able to realize approximately $23.9 billion dollars in bonus payments in 2006. In 2007, Swiss bank UBS paid out $10 billion Swiss Francs in bonus payments alone. Wrong compensation programs are also a reason behind the disasters at Enron, Worldcom and other companies and the subprime crisis. If all market participants behave at the costs of the system because of the false incentives through compensation programs this is alone sufficient to create a systemic crisis. The short term oriented bonus payments are therefore one main reason for the subprime crisis.

The meaning of corporate identity and especially the internal and emotional moral commitment of employees to the company has faded into the background over the past few decades, which has only increased the effects of the principal-agent issue. It used to be expected of managers that they work their way up the chain in their company, or at least are acquainted with the most important value creation levels and have assumed the corporate identity. This not only had the advantage that the manager could better judge the effects of their decisions on the company by knowing it well and identifying more strongly with the company. A poor personnel selection was also less likely to occur through the hidden characteristics issue, since the manager had already proven himself over the course of several years in the company. The principal-agent issue can really only be overcome by increasing the common interest of agent and principal, or to formulate it more generally, by encouraging the identification of the agent (manager) with the company, so that he becomes a bit more like the classical entrepreneur described above. The issue of the hidden characteristics, hidden information and hidden actions is found at every level of management down to the subordinate, decision-implementing units. A total management approach is thus needed, as we will describe in the second-to-last chapter of this book.

Conclusion
We note that stock options can all lead the manager to create long-term disincentives (moral hazards) if the risks and chances are not balanced between the principal and the agent, and the manager does not behave morally. The same applies to the performance-related remuneration if it is granted in the short term and enables the manager to retire after a few years. A risky, short-term oriented behavior of the manager at the expense of the company is provoked by such incentives. A one-sided participation of the managers in the positive development of the company, ie profit participation without a loss participation, leads to a strong risk-taking of the manager at the expense of the principal. A risk-adequate, ie balanced remuneration according to the opportunity and risk profile of the respective position is important in order to avoid distortions in the managers' decision-making.[114] If all market participants behave to the detriment of the system as a result of wrong behavioral incentives, this alone is sufficient to create a crisis. The wrong incentives in the form of short-term overpriced bonuses are therefore a major cause of the subprime crisis. The consequence was an immoral behavior of managers at the expense of companies, customers and society. Even morally oriented people find it hard to resist millions of dollars because of the constraints of survival. Not to be forgotten is that in the US education and health have to be financed privately. In 2006, bonuses received from US house credits alone amounted to US $ 23.9 billion. In 2007 alone, UBS poured 10 billion Swiss franc bonuses.

7.3.3.3 Fair Compensation

It is surely indisputable that a top manager receives a higher salary than a worker, and that this can be a cause for jealousy. The worker and the broader public may see such wage differences as unfair. But not all people are the same, and thus not everyone is equally qualified to hold a top management position. What distinguishes the position of a top manager compared to an employee or worker? In the end it is the importance to, and effect on, the company. Both top managers and workers are employees of the company and should work hard for the good of the company. A day has only 24 h for both of them, which is why overtime for the manager is also limited. However, the decisions made by a top manager have operative and strategically fundamental influence on the company, which is not the case for a normal worker or employee. The success or failure of a company is attributable to the

[114] See Conrad, Christian A. (2015).

management in the end, since they determine how an enterprise deals with changing environmental influences. The position of a top manager has one particularly important characteristic, namely the responsibility for the success of the company, and thus for all others dependent upon a company's success, such as investors, outside creditors, employees, customers, suppliers and others (applies to politicians as well.) It is therefore of existential importance for all companies that they have managers giving their best. Top managers are therefore remunerated like princes and companies try to outbid each other with salary offers in order to attract the very best. Besides power from their responsibility, they are attracted by social prestige and recognition, and recently by stock options as well. To get these privileges the managers work themselves into the ground, sacrifice themselves to live up to the task and responsibility and thus to achieve more benefits for everyone.

This would be the ideal, but the subprime crisis and Enron and the others have shown that reality is often very different. Companies go bankrupt, banks and shareholders lose everything, yet the top managers responsible retire with millions in profits from the sale of their shares to enjoy. Even if the company survives, but its situation is permanently damaged, the top managers may be replaced, but get millions in compensation. Many companies do poorly despite offering the highest manager salaries.

It is difficult to understand why a manager who does not improve the company, or who even makes it perform worse, should receive a high salary. Enterprises are often restructured, leading to extensive layoffs. The employees to lose their jobs are still responsible for their families and have a hard time understanding why they were let go when they had always fulfilled their duty to the company, receiving a set salary for working hard and performing well for the good of the company, and doing so for years or decades. The employees are liable with their jobs as a consequence of poor decisions from management, even though they are not compensated for the entrepreneurial risk with their salary despite small settlements from social funds. Managers on the other hand, receive not only sometimes huge compensations, but can sell their stock options in time before a fall in prices due to their insider knowledge. In the end the top managers are the first to see that the enterprise they are managing will not reach the given targets. In the case of bankruptcy, the shareholders and stakeholders such as employees, suppliers and credit institutes foot the bill, which perverts the principle of enterprise liability. The same applies for liability insurance without a deductible. If you want a manager that works hard for the enterprise he is entrusted with, the top managers will have to become more like the liable entrepreneurs. Currently they are just overpaid employees.

Measured on salary, in 1999 the best top manager in the USA, and probably in the world, was doubtlessly Enron's Kenneth Lay. He had the largest salary package with $44.2 million.[115] Outsiders often logically assume that the best man or woman is at the top of a company. They assume that the people who have proven their performance, know-how and personality and worked their way up in that company or another, is trusted with the power and responsibility to direct the fate of the com-

[115] See http://en.wikipedia.org/wiki/Kenneth_Lay dated October 08, 2006.

pany, and thus that of the stakeholders and shareholders. Since there is also a market for managers, we might imagine that the company prepared to pay the most for its managers also gets the best managers. This argument is often used by the top managers when they are defending their salaries. Taken to its extreme, this would mean that the companies should go to their credit limit to purchase the best management board, as everything is dependent upon good leadership. The best managers would then be found in the largest companies since they can afford the highest salaries relative to their sales. As a logical consequence, the poor managers would be in the small companies. Since the best managers make the right decisions and the poor managers make the wrong ones, the large companies would continue growing and the small ones would shrivel away. The large companies ABB, Enron, Worldcom, General Motors, Chrysler and Daimler or Citgroup and AIG would have had the best managers, while small companies such as SAP, which has doubled its size repeatedly, would have the poor managers. Of course everything depends on the management. A poor company can be managed successfully even in a difficult branch, where demand is decreasing. According to a survey of German liquidators, the main reason for insolvency is mistakes in management.[116] Especially in the day and age of global markets, there is a demand for management that can adjust to changing conditions every day, such as a new competitor. In fact, a top manager must be able to predict the changes. He must be a visionary, like Jules Verne. Predicting all of the developments in a global economy would have been too much for even Jules Verne, however.

If top managers want top salaries, they also have to provide top performance and be a model for their employees. In the end they also represent the company to the world outside, determine strategy and corporate identity. They shouldn't wonder that they are the object of people's anger when they perform poorly and then get rich unjustly from the company, such as in the case of ABB. The charismatic company managers Percy Barnevik and Göran Lindhal took 148 million sfr and 48 million sfr before they left ABB with an annual loss of 700 million sfr. That is not all, however. ABB was involved in several bribery cases, and according to insiders this was mostly because of the immoral example the top management set for the rest of the company. When the ex-Aventis head Dormann took over ABB he considered corruption one of the main problems of the company. He took drastic measures and instituted a code of ethics that every employee had to sign. Forty to fifty employees were fired from ABB over cases of corruption in 2004 alone. Employees were able to report suspected corruption via a whistle-blowing program.[117]

Top managers must provide top performance, which includes taking responsibility for decisions. The tendency to prepare decisions via management consultants is understandable with the background of how much pressure is on managers to justify themselves to their boards, but it is not understandable when we remember that a top manager is actually always supposed to have the information and competence to manage his company and his employees independently. Following this thinking, the

[116] See Handelsblatt dated June 25, 2006.

[117] See Handelsblatt dated August 10, 2005, p. 10.

head of DaimlerChrysler Dieter Zetsche, in contrast to his predecessor Schrempp who resigned, believes that the development of the company is a task belonging to the top management, and excludes the option of falling back on management consultants.[118] External management consultants are only justifiable in certain situations in which the company management is unavoidably overwhelmed, such as in company crises where important decisions must be made under enormous pressure to act in very little time. In these crisis situations management is already overwhelmed with the task of finding and evaluating the necessary information to make short-term decisions. Management consultants are often hired however, to lend support for the decisions of the top management with their name. Seen thus, they are usually purely public relations consultants, and always a sign of weak management. The quality of the consultation is not the most important, but rather the big, impressive international name of the consulting firm.

The compensations of bank managers increased also before the financial crisis of 1929 in exorbitant highs. Like today they resulted from extremely risky speculations. The high manager salaries and the business crises are also a symbol for weak shareholder control. Why should a manager get what a entrepreneur deserves. He is only an employee and is not liable with his capital. The only thing he can loose is his job.

The fact is that the board of directors has a huge amount of power and controls from the non executive directors are limited. The non executive directors might be also executive directors of other companies. If there is no direct conflict of interests at least they will all have the same interest in increasing the salaries of managers.

The fate of the company is therefore bound up with the ability and integrity of the board of directors for good or for evil. In other words, the board also has a large responsibility. A high salary is thus not only reasonable, it is also necessary. The board of directors must share in the consequences, including personal liability through private assets, whether as a repayment requirement from bonuses received or a part of the salary. It should in fact be counterintuitive to the ethos of a manager to receive a large compensation if the company is doing worse after his management than before. The motto for management should be "First the company, then me. He should want to be the last to leave the ship, not the first. A lack of professional ethics is also the expression of a lack in morality. In the contribution made by a manager for the value creation of a company, we must differentiate between his individual contribution and that of his position. The importance of an executive position for the company is alone a source of value creation, if the job is fulfilled without any large mistakes.

It is conceivable to place a manager from a level lower in the company in the position of CEO and continue to pay him his lower salary. The personal limit product of the manager must be decisive for an above-average salary, i.e. what he contributes in above-average value creation to the company. This is why many managers in the top positions stress their irreplaceable above-average performance and their uniqueness. The time they spend in the top management position is too long for this

[118] See Wirtschaftswoche dated January 12, 2006, p. 11.

to be true however, since if they were so incredibly unique, we must assume that there would be no higher priority for other companies than to lure them away. Unfortunately in practice it is not always the best managers that make it to the top. Apparently the reverse is true when filling top management positions, that there is too little competition and transparency, otherwise there would not be so many company crises as a result of poor personnel decisions. The incentive schemes in salaries make it possible, even encourage and strengthen the chances, to get rich in the short term at the cost of the company. But even poor personnel decisions could be controlled and we must ask ourselves why a single person can cause so much damage in a company.

7.3.3.4 Lack of Controls on Company Management

Another reason for the crisis at Enron, Worldcom & Co. is apparently company managers with too much power. Jeff Skilling at Enron, Bernie Ebbers at Worldcom, Percy Barnevik at ABB, John Chambers at Cisco, Jean-Marie Messier at Vivendi, Cees van der Hoeven at Ahold, and last but not least Dennis Kozlowski from Tyco managed their respective companies like autocrats with their charismatic and exaggerated self-confident personalities. Blinded by initial success, companies and investors followed them right into the downfall. This is a human phenomenon of groups, which can often be observed wherever there is a large concentration of power. At some point the powerful people themselves begin to believe in their infallibility, get careless, uncritical, and only tolerate yes-men around them. In companies this is often reflected in an attempt to garner more and more power through expanding mergers, which at some point can no longer be controlled and end up overwhelming the company. The record in this phenomenon is held by Tyco, with up to 200 company takeovers in its heyday.[119] Kozlowski later served a 25-year sentence for fraud and other offences, and the investors, stockholders and creditors of Tyco were granted the right to sue the ex-Tyco auditor PriceWaterhouseCoopers. They had over-reported $5 billion in profits, which is why the new management reached an out-of-court agreement to pay $3 billion in damages.[120]

Many top managers show weaknesses both in their personality and in their skills, which have almost ruined some companies (such as ABB and DaimlerChrysler) and have completely ruined others (Enron and Worldcom). Where does it come from? How are management positions awarded, if performance, ability and integrity are not the deciding criteria? Hiring decisions always carry with them the risk of the hidden characteristics, as previously discussed. People who are capable of presenting themselves well, and don't take truth all too literally, always have the advantage. For an employer, or a BoD, can only be accused of poor personnel decisions to a certain extent, but later they can certainly be held accountable for not acting once the weaknesses of the manager hired become clear. There is another aspect that is

[119] See Probst, Gilbert/Raisch, Sebastian (2004), pp. 38.

[120] See Handelsblatt dated May 16, 2007, p. 11.

much more important. A company is above all a functional cooperation of many people, an organization. It is about people, power, influence, welfare and the distribution of all of these. In this environment politics becomes important, increasingly so as the companies get bigger.

Let us assume that people are evolved from apes. As has been observed in groups of apes, a hierarchy, that is power and recognition, is not determined by the strengths of individuals, but by political influence in the group. The key is the relative strength of all the group members an individual can get to support them. If one group member wants more power than others, it must build alliances. The supporters are generally strong, otherwise they could not assert themselves among the alliances, but the qualifications, the strengths necessary for this, are not identical to those of a specialized qualification or ability to run a company. What is needed here are political abilities, such as communicating to others that their interests (also power, influence and remuneration) are best represented in the company. It is in fact possible that two rival and equally strong alliances will not manage to impose their desired candidate and thus agree on a compromise candidate. This candidate is often professionally and politically weak, so that he cannot damage the alliances in the key position he will have. There are also paradoxes in internal promotions. Performance is not always transparent. Appearance is often more important than the truth. Appearances can deceive however, and there are people with an exceptional talent to do so. Another example: as a manager with a strength in implementation works his way up the ladder, those who have supported his rise in power usually come as well. These are the people who are unconditionally loyal, as well as employees who are not qualified managers, but the ones who never criticize the manager and never have – or at least do not voice – a conflicting opinion and give only positive feedback, in other words the yes-men. They do not really have their own personality, and at most have perhaps half of the potential needed to be a good manager. The manager chooses these people himself. He usually prefers those who do unconditional dirty work and yes-men to creative thinkers and personalities not only because they are more comfortable to have around, but because they will protect him from supporting an equally qualified, or even a better qualified manager in his sphere of influence. Such a person could steal the show, and then even the position. Better to have just one light shining in the darkness. The head of Citigroup, Prince, followed his charismatic foster father Weill to the top position. The lawyer by profession is rumored to have had absolutely no experience in operative banking business when he took up the position.[121] The deputy of Richard Fuld, the head of Lehmann (Joseph Gregory) is said that his greatest strength was that he could not become dangerous.[122]

Of course, one must be able to afford such a politically motivated "mistake" in personnel. At best only large companies can afford such a move, since there are enough other employees to compensate the reduction in value creation through this poor selection. The more important the position for the company, the higher are the

[121] See Handelsblatt dated November 11, 2007.

[122] See Der Spiegel 11/2009, pp. 43.

costs of a poor decision. Generally, we can say that such personnel choices can only be supported if the manager has no one holding him accountable or the effects of their poor performance are not obvious due to a lack of a clear chain of responsibility or appropriate controlling.

Effective controls from the Board are all the more important via representatives of the stockholder interests, and separating the CEO from the controlling board chair is the absolute minimum requirement. In larger companies the Chairman of the Board should be a well-paid full-time job. He should also be personally interested in the company's success and thus involved in long-term oriented option programs. It must be assured that control over the Board is objective, and thus impartial. This applies for both auditors and supervisory boards. Previous management of the same firm are just as poorly qualified for this job as the management of firms in which the management to be checked, or their friends and family, sits on the supervisory board. Due to the professionalism and identification of interests, mutual stock funds for this task would be the best form of payment, followed by funded insurance systems. A positive example for the successful representation of stockholder interests is Calpers, the world's largest US pension fund. It not only refuses to lay off managers who have not represented the interests of the stockholders in its view, but is also involved in politics whenever stockholder interests are affected. The fund refused, for example, to agree to dismiss managers who paid their auditors for tasks other than checking accounts. Many companies reacted and now separate audits and consultations.[123]

The disproportionate development in salaries can thus be attributed to a lack of controls on company management. Why should a board that does not think morally deny itself enrichment, if there are no consequences to be feared?

Conclusion

All in all, the Management Board is governed by the company and the Supervisory Board's control facilities are limited. Often, the supervisory board members are also board members of other companies. Even if this does not lead to a conflict of interests, they have at least the same interest in increasing the level of managerial remuneration. For this reason, the company's fortunes are linked to the ability and integrity of the Executive Board. Or in other words, it carries a great responsibility. A high salary is therefore not only appropriate, but also necessary. But the responsibility must also be borne by the board, which should also include personal liability with private assets as with the entrepreneur, whether as a repayment obligation of bonuses or salary components received. Actually, it should contradict a manager's professional ethos that he gets a high compensation if the company functions worse than before. And actually, the motto for management is "first the company and then me." And like the captain of a sinking ship, he should be the last to leave the ship and not the first. Lack of professional ethos is always an expression of a lack of morality.

[123] See Handelsblatt dated November 08, 2004, p. 2.

Summary
Unfortunately, it is not the case that only the best managers rise to the top, otherwise there would be no corporate crises as a result of manager failures. Obviously there is too little competition and transparency in the process of filling top management positions. The incentive mechanisms for salaries, which make a short-term enrichment possible and even at the expense of the company, reinforce this. The wrong incentives in the form of short-term overpriced bonuses are a major cause of the subprime crisis. A risky, short-term oriented behavior of the manager at the expense of enterprise, thus an immoral behavior, is provoked by such incentives. At least partial liability is necessary to remedy incentive distortions and to ensure a risk-adequate remuneration.

Comprehension Questions
1. Can the company recognize when someone is a moral and good manager? Justify their assessment.
2. How can you explain the increasing wage differential between top executives of stock exchanges and employees of lower salary levels?
3. How would you reward your top manager as a corporate owner? Explain your position.

7.3.4 Ethical Corporate Culture

7.3.4.1 Case Study: VW Diesel Scandal

The Scandal
November 20, 2006, the technicians of VW Chief Engineer Rudolf Krebs discovered that they could not technically meet the stringent emission guidelines of the US market. The technicians found a solution. They manipulated the results in the exhaust gas tests by installing software that regulates the exhaust gases only in the test cycle. According to participants of a meeting, Rudolf Krebs said: “We’ll do it, but we must not get caught.”[124]

On September 18, 2015, the US Environmental Protection Agency (EPA) published that VW intentionally bypassed emissions regulations for more than half a million diesel vehicles. In an e-mail from the United States Environmental Protection Agency (EPA) to VW of 18 September 2015 states:

> “the EPA has determind that VW manufactured and installed defeat devices in certain model year 2009 through 2015 diesel light-duty vehicles equipped with 2.0 liter engines. These defeat devices bypass, defeat or render inoperative elements of the vehicles’ emission control system that exist to comply with CAA emission standards.”[125]

[124] http://www.ndr.de/nachrichten/niedersachsen/VW-Anatomie-eines-Wirtschaftsverbrechens,vw2936.html.

[125] https://www.epa.gov/sites/production/files/2015-10/documents/vw-nov-caa-09-18-15.pdf

With low exhaust emissions, the company won several environmental awards and started the "clean diesel" marketing campaign. This marketing campaign was extremely successful and helped the VW Group sell 11 million manipulated vehicles until the fraud was discovered in September 2015.

Consequences

The exhaust gas manipulation led to compensation claims against VW, possible tax payments, reimbursement of production money, as well as the uncertain future of current and future diesel models. VW and Audi, Seat and Škoda had to call back millions of cars and also reprogram the engines of new cars. Last but not least there is huge image damage.

VW has agreed on a settlement of 15 billion US dollars with the American authorities. This sum is provided by VW for the repurchase and conversion of affected vehicles, as well as for the establishment of environmental funds. In Canada, the VW Group has negotiated a settlement of 2.1 billion Canadian dollars (1.5 billion euros) for redemptions and compensation payments. According to expert estimates, the entire cost of the exhaust gas scandal will amount to 30 billion euros. The number of VW car registrations has declined since the scandal. For these reasons, VW has set up a plan called "the future package." With this plan, VW will save €3.7 billion annually in the German plants alone. Much of these savings are to be achieved by means of job cuts. In the German plants, around 20,000 jobs are to be cut by 2020. Worldwide, another 10,000 jobs will be lost. Furthermore, the model diversity will become significantly narrower.

Worldwide 11 million vehicles have to be retrofitted. VW does not, however, guarantee any consequential damage after the conversion and keeps the technical details of the software update secret, so that an independent expert can never check for error.

The CEO Winterkorn accepted partial responsibility and stepped down in September 2015. At the time when Winterkorn was told of the manipulation, he was the highest earning manager in Germany. In summary, Martin Winterkorn received 35.3 million euros in the years 2012–2014 with a fixed share of 5.7 million euros. This shows that over 83% of Winterkorn's earnings were dependent on the company's success.

It is currently known that Winterkorn had known about the exhaust gas manipulation since May 2014. The public prosecutor's office in the German town of Braunschweig opened an investigation against Winterkorn for fraud suspicion in January 2017. The investigations were based on witness testimonials and evaluations of confiscated files which showed that Winterkorn "could have had previous knowledge of the manipulating software and its effect."[126]

Winterkorn and co-owner and supervisory board Ferdinand Piëch had set themselves the goal of overtaking Toyota in 2018 as the world's largest automobile group. It succeeded in 2015. The Swiss psychotherapist Theodor Itten discusses

[126] http://www.spiegel.de/wirtschaft/unternehmen/martin-winterkorn-staatsanwaltschaft-ermittelt-wegen-betrugsverdacht-a-1132013.html

another aspect as an explanation for the rapid rise and the surprisingly rapid descent of such managers. His book "Größenwahn" (english: megalomania) deals with many heads of top managers, who failed in a similar way. "Many managers have a morbid exaltation of themselves – which ultimately causes them to crash,"[127] says Itten, diagnosing a narcissistic personality disorder. This is responsible for many managers who have made their career even to the top level.[128] "The same character traits that help managers to rise, let them often also fall down. This is the problem."[129]

Solution

1. Conviction ethics: VW deliberately manipulated the exhaust gas values, which is why an honest attitude can not be presumed. Winterkorn did not do anything about it. The customers were deliberately deceived by the advertising of "clean diesel."
2. Kant's rules of ethical reasoning: a) Categorical imperative: general law? If every automotive producer manipulates, the environmental impact would be enormous: No! Do you want to be affected by such a behavior yourself as a car purchaser or environmentally conscious person? No! B) Publicity rule: The rights of the public and VW buyers have been violated: No! C) Practical Imperative: No, the environment and customers were deliberately deceived by advertising "clean diesel" to maximize profit.
3. Duty ethics (deontological ethics): No, the environmental requirements were clear.
4. Implications (teleological ethics): Environmental requirements served the purpose of protecting nature and people. There were customers who were willing to pay a higher price.
5. Moral economics: There was apparently no adequate government control that would detect and punish the manipulation of exhaust gas values, so every automobile producer was forced to cheat.

http://www.ndr.de/nachrichten/niedersachsen/VW-Anatomie-eines-Wirtschaftsverbrechens,vw2936.html; http://www.manager-magazin.de/fotostrecke/volkswagen-die-chronik-des-abgasskandals-fotostrecke-131601-42.html; https://www.epa.gov/sites/production/files/2015-10/documents/vw-nov-caa-09-18-15.pdf; http://www.spiegel.de/wirtschaft/unternehmen/martin-winterkorn-wird-70-die-arroganz-der-macht-a-1149070.html; http://www.tagesschau.de/wirtschaft/vw-vergleich-103.html; https://www.tagesschau.de/wirtschaft/vw-kanada-101.html; *Handelsblatt* 71 (224), S. 6–7; http://www.focus.de/auto/news/autoabsatz/neuzulassungen-im-juli-passat-zulassungen-brechen-um-25-prozent-ein_id_5702913.html; Volkswagen Aktiengesellschaft: Konzernabschluss 2013,

[127] http://www.spiegel.de/wirtschaft/unternehmen/martin-winterkorn-wird-70-die-arroganz-der-macht-a-1149070.html. Translation by the author.

[128] See http://www.spiegel.de/wirtschaft/unternehmen/martin-winterkorn-wird-70-die-arroganz-der-macht-a-1149070.html

[129] http://www.spiegel.de/wirtschaft/unternehmen/martin-winterkorn-wird-70-die-arroganz-der-macht-a-1149070.html. Translation by the author.

2014 und 2015; *Die Kitzinger* 7, S. 21; https://www.welt.de/wirtschaft/article152865049/Winterkorn-wusste-schon-2014-ueber-Abgasskandal-Bescheid.html; http://www.spiegel.de/wirtschaft/unternehmen/martin-winterkorn-staatsanwaltschaft-ermittelt-wegen-betrugsverdacht-a-1132013.html; http://www.n-tv.de/wirtschaft/Zetsche-kritisiert-Volkswagen-article16770101.html

7.3.4.2 What Is a Company Culture?

Group Work How would you behave as an employee? Discuss the effect of the following examples:

1. In the company, there is competition among the employees as in "up or out," while the company management demands fair team play among the employees.
2. Openness, honesty and fairness are required, but only those who do not make mistakes are promoted. Mistakes can mean dismissal.
3. Honesty and modesty of the performance of the team are demanded, but the person is promoted who is bragging about a third person's performance and hiding his own mistakes.
4. Personal effort is required, though rewards are equal regardless of results.
5. The demand for personal performance and constructive criticism is demanded, but the one who eats lunch with the supervisor and agrees with everything is promoted.

As a result of the group work, the seminar participants showed a great discomfort and a rejection of the above examples. A clash of the individual culture of the employee and the company culture necessarily leads to the termination or at least to the internal termination of the employee.

Trust is quickly lost and building new trust takes time if it is possible at all. The rules a society makes determine its long-term success. Rules that are implemented determine human behavior within the society through rewards or punishments, which are signals that make those rewarded into role models and those punished into deterrents. The unjustified enrichment of a top manager also acts as a "role model." If a high level boss does not have to make an effort and show above-average performance through hard, honest work, what can be expected from a lower level employee who is paid much less? What kind of company culture with what kind of performance would there be if all employees behaved that way? Immorality then pays off. Loyalty, morality and honest work are devalued with such salaries, which must reduce the motivation to behave in accordance with the system and to work hard and productively. If this kind of behavior is allowed to pay off, it would not only crush the system economically, it would also be a step backwards for civilization. A democracy is based on certain values and principles, which are understood as a "social contract." Égalité, fraternité and liberté contain something like a minimum of performance fairness and equal chances. An openly tolerated, unjust enrichment not only goes against these principles, it provokes jealousy and thus strips away social consensus (peace).

Moral behavior must be worth the effort. Poor examples undermine morality, which applies both within a company and a national economy. Others will see that it pays to get rich at the expense of the company, or other economic participant,s and will try to emulate those who do. The top manager who has gotten rich by selling his stock options even though he has hurt the company he was entrusted with, will find copycats as well as corrupt buyers. If this damaging behavior is not sanctioned, then rationally, honesty would be a poor choice because it does not pay out. Mores fall apart, or better the morals of the actors, who damage not only the company or individual person but the system as a whole.

Corporate principles have to be lived out. If employees and executives behave differently than the corporate image, it becomes a waste of paperwork. Argyris differentiates official behavioral requirements (espoused norms) and actually lived norms or norms-in-use.[130] Decisive for the ethical behavior of all people in a company, are the actual norms-in-use in the form of so-called corporate culture. These are all norms, values and behaviors that define the behavior of people in the company as a group (**definition**).

The same people can have several cultures, depending on which group or community they are a part of. A culture deviating from the corporate culture would be e.g. the behaviors, norms and values in the family. Corporate cultures can be differentiated in a group as subcultures of many individual working groups. Depending on the location, international corporations have divergent cultures.

The company cultures contribute decisively to the success of the company. They are a competitive factor because they directly influence the co-operation of the employees and thus the added value of the organization, mainly from the division of labor and the synergy. Already in the 1970s, Americans developed the concept of corporate culture as a management approach. Here, they explained, among other things, the differences in productivity between American and Japanese companies. The Japanese employees were characterized by a higher discipline and willingness to cooperate.[131]

In the early 1980s, Hofstede described the connection between the general culture of a country and the behavior of the people in the company by interviewing IBM employees in 71 countries with a questionnaire on their behavior for 10 years. He showed that the behavior of managers is strongly influenced by their culture, which is particularly reflected in their leadership and the organization of the company process.[132]

From the answers Hofstede developed four cultural dimensions for describing cultures:

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[130] See Argyris, Christ (1994), pp. 216 f.

[131] See Schreyögg, Georg (1991). Steinmann, Horst/Schreyögg, Georg (1991), pp. 12; Steinmann, Horst/Schreyögg, Georg (2005) and Geißler, Cornelia (2010).

[132] See Hofstede, Geert/Hofstede, Gert Jan/Minkov, Michael (2010).

1. an individualistic versus a collectivist culture, in which the American corporate cultures are given an individualistic character and the Japanese a collectivist.
2. a different acceptance of status differences (power-distance)
3. a different risk assessment or uncertainty avoidance (uncertainty avoidance)
4. More male or female dominated cultures (masculinity / femininity)

According to the Waters study, four out of seven criteria that prevent ethical behavior in the company are attributable to corporate culture:

1. an unethical role model function of the superiors, as a general toleration of unethical behavior or as unethical socialization, thus modelling of such behavior by the superiors. In particular, initial start-ups can be influenced.
2. an overgrown group loyalty that prevents misbehavior from being reported to the outside and encourages competition among the groups.
3. a strong orientation of the success indicators on quantities in the case of a simultaneous internal undervaluation of ethical, qualitative factors, especially in order not to endanger the quantifiable goal fulfillment. This results inter alia in an inhibition to openly address moral aspects in the company.
4. A tendency of the company, thus indirectly all employees in the company, to hide ethical violations, in order to prevent a poor image and possible punishment from the outside.

Corporate cultures represent the established orientation patterns for behavior in the company. These orientation patterns are deeply anchored on an unconscious level. They reduce complexity and give the employees behavioral security. An entrepreneurial function is attributed to the corporate culture. As a rule, a change in the habitual culture is rejected by the employees, and the especially if this behavior was successful for the employees.[133] Culture is an identity-building and preserving factor. This aspect is reflected in Schein's definition of organizational culture. It defines it as "a pattern of common ground prizes that the group has learned to deal with their problems of external adaptation and internal integration, which has proven itself and is therefore binding; And is therefore passed on to new members as a rational and emotionally correct approach to dealing with problems."[134]

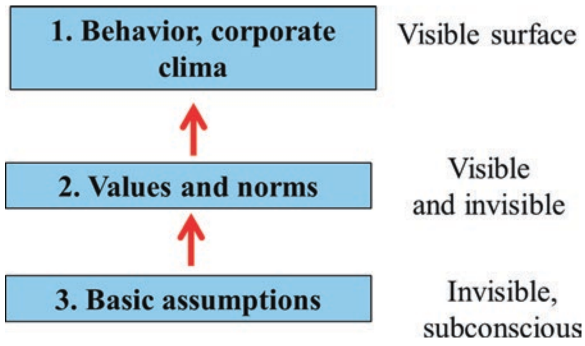
According to the popular cultural model of Schein, there are three cultural activities:

1. The cultured surface is determined by the behaviors and process results. They are the first to be recognized in the company, but they must be interpreted. Visible behaviors are expressed, in the language, manners, rituals and clothing (as well as myths and artefacts, such as the company building and office facilities and equipment). This also includes the corporate identity as well as the company's

[133] See Schreyögg, Georg (1991), pp. 208.

[134] "…a pattern of shared basic assumptions that was learned by a group as it solved its problems of external adaptation and internal integration, that has worked well enough to be considered valid and, therefore, to be taught to new members as the correct way to perceive, think, and feel in relation to those problems." Schein, Edgar H. (2004), p. 17.

Fig. 7.13 Organizational culture by Schein



operating environment, how people deal with each other and the way they interact with other stakeholders, such as suppliers and customers.

2. On the next level are the norms and values which control the behavior of the employees. Standards are the guiding principles, the behavioral guidelines, if they are also lived. They are only partially visible through the behavior. Man can partially recognize the values of the organization and deliberately question and influence them, but they are also partly hidden in the subconscious. Collective values are, for example, honesty and reliability, ie attitudes that determine the behavior of employees.
3. At the deepest level, in the subconscious, there are basic assumptions. They are so deeply anchored that they are not consciously perceived by members of the organization. They are thus not directly recognizable. These are the dispositions of behavior which, without thinking, are assumed to be self-evident. It is a spontaneous way of reacting to the environment. These basic assumptions about reality, the environment, are not questioned or discussed. These include ideas about the meaning of life or religion (Fig. 7.13).

7.3.4.3 How Does the Corporate Culture Influence the Employees?

Empirical studies show the influence of corporate culture on company activities. Cullen, Parboteeah and Victor showed that a company culture perceived as ethical by the employees had a positive effect on the commitment of employees in the company organization.[135] In an ethical corporate culture, managers are increasingly ethical.[136] Finally, the employees lie less in an ethical corporate culture.[137]

Corporate culture is therefore the most important criterion for company success, but unfortunately it is also the criterion that is most difficult to influence. In fact, the corporate guidelines, the officially desired behavioral rules, often differ from the

[135] See Cullen, J. B./Parboteeah, K. P./Victor, B. (2003).

[136] See Flannery, B. L./May, D. R. (2000).

[137] See Ross Jr., W. T./Robertson, D. C. (2000).

actual, "secret rules of the game."[138] All other instruments for the purpose of winning will fail if the corporate culture does not communicate them. Can it be a good strategy if it can be seen as a contradiction to the behavior of employees and therefore cannot be implemented? Ethical behavior in the company therefore requires an ethical corporate culture. Otherwise, ethical behavior as a violation of norms would be sanctioned by the other employees (and vice versa).

In groups, people take on roles that influence their behavior. Groups have a group-adjusted morality behavior with their own norms. Groups can increase productivity, through control or cognitive stimulation. Conversely, the wrong norms of a group can also lead to opportunism, conformity, and adaptation of the group members. This would lead to a herd behavior in an ethically wrong direction, as was the case with the group norms of the bankers within the framework of the financial crisis (group-think effect). Deindividuation promotes social lounging if the performance of the individual cannot be controlled. An individually identifiable performance enhances performance through social competition. The attitude of the group and the individuals influence each other. The individuals adapt themselves to the group in order to be socially accepted (social comparative processes or the pursuit of conformity). Norms can lead to moral behavior, as demonstrated in experiments.[139]

Muzafer Sherif had already conducted an experiment on group adaptation processes as early as 1935. Subjects would estimate the removal of a light from their eyes. On the basis of the so-called autokinetic effect, all subjects estimated differently. In a second pass, the subjects were able to communicate their assessments to each other. The result was that they matched their minds over time.[140] Jacobs and Campbell showed in 1961 that group norms that arise in an autokinetic situation as group adaptation processes are passed on by generations of groups but lose influence.[141] Weick and Gil-fillian found again in 1971 that such group standards lasted longer when viewed as efficient and fair.[142]

Game 6: Asch Conformity Experiment

1. The following picture is shown to the students with a beamer. The students are asked to estimate the number of telephones and to write the number on a paper (Fig. 7.14).
2. The following picture is shown to the students with a beamer.

80% get the wrong information on a folded paper says that 280 telephones are pictured. They are asked not to show the paper to the others. Then there is group

[138] See Scott-Morgan, Peter (1994), pp. 29.

[139] See Aronson E./Wilson T. D./Akert, R. M. (2008), pp. 241, pp. 285; Jonas K./Stroebe, W./Hewstone M. (Hrsg.) (2007), pp. 374 and Bierhoff, H. W. (2006), pp. 413.

[140] See Sherif, M. (1935); Aronson E./Wilson T. D./Akert, R. M. (2008), pp. 234 and Bierhoff, H. W. (2006), pp. 414.

[141] See Jacobs, K. C./Campbell, D. T. (1961) and Bierhoff, H. W. (2006), p. 415.

[142] See Aronson E./Wilson T. D./Akert, R. M. (2008), pp. 241.; Jonas K./Stroebe, W./Hewstone M. (2007), p. 374; Bierhoff, H. W. (2006), pp. 413 and Dobelli, R. (2011), pp. 17.

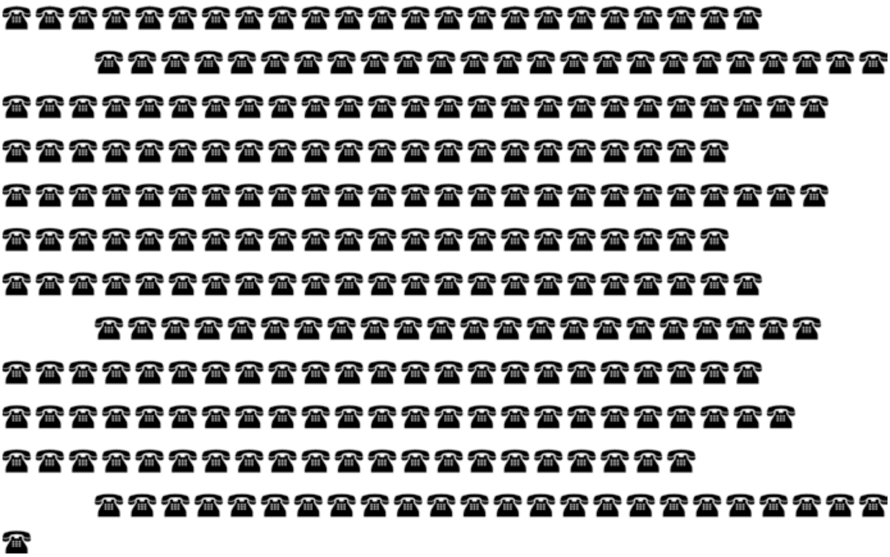


Fig. 7.14 telephones 1 (Solution: 12x20 + 40 = 280 telephones)

discussion about the number of telephones. It can be seen that the students who have to estimate will adjust their estimation to the wrong information of the group majority (Fig. 7.15).

3. The following picture is shown to the students with a beamer. The students are asked to discuss the number in the group. After 5 min the students should write their result on a paper. Then the results are compared to the number on paper of the first experiment. The difference in the individual estimation is the group influence (Fig. 7.16).

Solomon E. Asch conducted an experiment in 1955 in which individuals in a group should say which of three strokes is longer. Approx. 37% went for the wrong group opinion, if it was presented with sufficient confidence. With the Asch Conformity experiment Solomon E. Asch demonstrated that individuals can also adapt to wrong group opinions when the group represents them self-confidently.[143]

It has been demonstrated with fMRI brain scanners that people feel negative emotions when they behave differently from the group. In the experiment by Gregory Berns et al. the subjects should say whether two figures are identical. Aids were given as subjects and 2/3 of the subjects reported false results. The remaining 1/3 subjects, who did not know the wrong results, struggled in the brain areas responsible for seeing and perceiving. The same held for the subjects who knew the answer was wrong, but asserted this opinion. Only in the subjects who expressed their opinion against the group opinion was the brain area that is relevant for nega-

[143] See Asch, Solomon E. (1951) and Jonas K./Stroebe, W./Hewstone M. (2007), pp. 9, pp. 379.

Fig. 7.15 telephones 2 (Solution: 12x20 + 31 = 277 telephones)

tive emotions and for social behavior active.[144] In this way, people are seen as social creatures who are already living on a group-formality and who already feel social non-acceptance as punishment (normative social influence).[145]

In an experiment by Robert Cialdini, Raymond Reno and Carl Kallgren, two different areas were created in front of a library: a clean area and a dirty one. Afterwards flyers were stuck to the windshield and people's behavior was observed. In the clean area only slightly more than 10% of the subjects threw the flyers to the ground and the dirty area was about 30%. Sociology here speaks of descriptive norms (or perceived norms), since they are perceived only by the behavior of others in concrete situations, regardless of whether the behavior is socially desirable. The environment had been polluted by others, although this was contrary to the norm so most people acted accordingly. In the second experiment, the researchers once left the visual area clear from all dirt and paper and once they demonstratively threw papers on the ground. In the face of the good example only around 8% threw the leaflet on the ground and in the dirty area even less than 5%. Apparently the dirty environment had a moral reinforcing effect. In this so-called injunctive (challenging) norm, peo-

[144] See Aronson E./Wilson T. D./Akert, R. M. (2008), p. 244.

[145] See Aronson E./Wilson T. D./Akert, R. M. (2008), pp. 241 and Jonas K./Stroebe, W./Hewstone M. (2007), pp. 379.

Fig. 7.16 telephones 3 (Solution: 12x20 + 40 = 280 telephones)

ple orient themselves to what behavior of others is actually desired in a situation. The importance of the model and culture for the behavior of the employees in the company also depends on this. Injunctive norms are more powerful than descriptive norms.[146]

The influence of authorities as negative role models can also be proved with the well-known experiment of Stanley Milgram of 1961. Subjects should teach other subjects and punish the students with electric shock if the performance is poor. They were asked to do so by the game leader in a white coat as an authority. They forgot the social norm not to harm others. 62.5% went up to the maximum of 450 volts.[147] In 2012 an experiment was carried out by and on Facebook, where the users' posts were manipulated. It was found that negative mail caused the users to more negative posts and vice versa. In this way, man is influenced morally by other people, which can be attributed to the influence of corporate culture as the behavior of many people on the individual employee.[148]

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[146] See Aronson E./Wilson T. D./Akert, R. M. (2008), pp. 259; Jonas K./Stroebe, W./Hewstone M. (2007), pp. 414 and http://www.cobocards.com/pool/de/card/4emnb0513/online-karteikarten-injunktive-und-deskriptive-norm/

[147] See Aronson E./Wilson T. D./Akert, R. M. (2008), pp. 261 and Jonas K./Stroebe, W./Hewstone M. (2007), pp. 400.

[148] See http://www.chip.de/news/Manipulation-Facebook-Experiment-im-Eigenbau_70849545.html; http://www.spiegel.de/netzwelt/web/facebook-experiment-aerger-um-manipulierte-news-feeds-a-978147.html#js-article-comments-box-pager and http://www.faz.net/aktuell/wirtschaft/netzwirtschaft/der-facebook-boersengang/facebook-managerin-sheryl-sandberg-entschuldigt-sich-fuer-psycho-experiment-13024578.html (retrieval 24.07.2014).

Immoral behavior intensifies immoral attitudes in a culture. Judson Mills checked the attitude of the students toward cheating at a primary school and then they had to take an exam that was so difficult it could only be passed by cheating. He explained to the students that they cannot be caught while cheating, but this was not correct. Some students did not cheat, while others did. Then the students were questioned again about their attitude to cheating. The students who had cheated had now a more lenient attitude to cheating, and those who had not cheated rejected cheating even more.[149]

7.3.4.4 Measurement of Company Culture

The first step would be to capture the company's culture in order to match it with the corporate guidelines. If there is a clear discrepancy, the culture must be changed. Surveys, and behavioral criteria, such as the ability to meet the needs of the customer, can be assessed through response times and customer queries.

Political science has a theoretical approach named Political Culture, which is here understood as the "distribution of political knowledge, value convictions, attitudes and behavior within the population at a specific point in time."[150] The initiation of this approach came from the question as to why democracy was sustainable in some countries and not in others despite the required system institutions and order, particularly where a democratic system had been newly installed. The concrete occasion for this question was the failed democracy of the German Weimar Republic, which led to Hitler's dictatorship. Political scientists determined that it is not sufficient to simply install a democratic order in the respective country. The system of order must be understood by the populace and carried by them as well. Political attitudes, thus the political culture, must fit with democracy. The methods to measure political culture are opinion surveys with direct and indirect questions, meaning hidden and control questions, which is generally known as opinion research.[151]

The political culture approach can be applied easily to the economically relevant attitudes, to all of the attitudes within the population of a country important to the economy. We can call this the "economic culture approach." The attitudes relevant to the functioning of society can be called the "social culture approach." What are the socially relevant attitudes? The most important have already been addressed; moral values that benefit living together in a community, and the functioning of social processes, such as reliability, honesty, helpfulness, a willingness to make sacrifices, as well as the readiness to observe societal rules by subordinating and restricting oneself. All of these characteristics are social capital because they are necessary in order for the society to create added value. Many of them are economically relevant because they reduce the costs of economic transactions or even enable

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149 See Aronson, E./Wilson, T.D./Akert, R.M. (2008), pp. 171.

150 See Reichel, Peter (1981), p. 26.

151 See Reichel, Peter (1981), p. 26.

them to take place. These characteristics are also what create trust. As we have already mentioned, even a simple exchange of goods would not take place if both parties fundamentally distrusted each other. It is possible to work around this problem through contracts and a functional legal system, at least to a limited extent, but it comes with high transaction costs. Business with less added value for the participants than the transaction costs is not sustainable.

For our purposes we differentiate between attitudes relevant to society, economics and business and we develop corresponding questions, although there are of course overlaps. The attitude of being "thankful" is a characteristic, but humans are capable of choosing their attitudes and continuing to be thankful, while a characteristic such as aggressiveness or violent-temperedness is not as easy to reconsider and change. Changing attitudes can also be very difficult, depending on how deeply anchored they are. Many attitudes have been part of our upbringing since childhood through our parents or society, without our even being aware of it. For our purposes we are particularly interested in the attitudes that can be influenced or changed. We assume that the characteristics of each personality depend on the character of the person and are thus innate. Characteristics shouldn't be expected to change between nations, nor change within the same society over time. The questions should make the Social Culture and Economic Culture Approaches understandable for the reader. The final questions serve to determine the attitudes of the people affected in a society or in a company. They must therefore use subtler, hidden questions and control questions, so that the interviewees cannot guess what the questions are getting at. The following questions are thus neither very open nor understandable, which would otherwise make negative associations in the questions clear.

We can find six basic characteristics relevant to a society, national economy or business.

1. Reliability 2. Loyalty 3. Team competence 4. Willingness to perform, 5. Integrity and 6. Acceptance of the system.

Reliability

A person is considered reliable if they keep their promises and agreements. Moral values such as honesty and responsibility belong to the category "reliability." Reliability is especially important for a company when the tasks delegated to employees must be correctly implemented and added value created through cooperation within the company. Reliability is also an important attitude for a national economy. The sum of productivity from all of the companies determines the productivity of the national economy, and reliability is very important for all transactions between companies and other market participants. A society considers it important that people can rely on one another, as they might in a marriage.

Possible questions would be (to be answered with yes or no):

- The saying "honesty is the best policy" just offers consolation for dumb people who aren't able to get what they want. (Answer expected from those who are reliable: no)
- My good reputation is important to me. (Answer expected from those who are reliable: yes)

– For me promises are declarations of intent. You can't keep every promise. I don't expect from others to always keep their promises. (Answer expected from those who are reliable: no)
– I try to spend time with my children every day and concentrate on their problems. (Answer expected from those who are reliable: yes)

Loyalty

Loyalty is generally considered lasting gratitude. In an ideal marriage for example, both husband and wife are thankful for mutual sacrifices. The employee is thankful to the company for enabling him to feed himself and his family, and for being treated well. The employee is therefore prepared to go above and beyond for his employer in the interests of the company as a way of giving back. Surely a certain degree of humility is necessary, since the opposite of humility would be make shameless demands, which cannot make loyalty any more likely. Employee loyalty is very important for companies. On the other hand, the employee is dependent on the company not dropping him whenever it might be advantageous.

Possible questions would be (to be answered with yes or no):

– I am thankful to have my job. (Answer expected from those who are loyal: yes)
– My employer needs me and I need my employer. (Answer expected from those who are loyal: yes)
– I am in the debt of whoever helps me. (Answer expected from those who are loyal: yes)
– I don't expect anything, but I am thankful for any help. (Answer expected from those who are loyal: yes)
– Everyone has to watch out for themselves. (Answer expected from those who are loyal: no)

Teamwork Capability

We understand individuals to be capable of teamwork when they are willing to subordinate or integrate themselves in a group in order to reach higher goals. Besides seeing the necessity to integrate oneself, positive feelings such as sympathy for others as the basis for helpfulness is part of teamwork capability. It is also required to reach a common performance within networks, and thus important for all companies. Society is also dependent on productive teamwork. Examples here might be self-administration, public social aid, church organizations and clubs with social functions. The national economy profits indirectly from teamwork through companies that are more productive.

Possible questions would be (to answer with yes or no):

– In a community everyone helps everyone else out. (Answer expected from those who are team capable: yes)
– Together we are strong. (Answer expected from those who are team capable: yes)
– The individual must sacrifice sometimes for the good of the whole. (Answer expected from those who are team capable: yes)

- Do not ask what your country can do for you, ask what you can do for your country. (Answer expected from those who are team capable: yes)
- I am a part of the whole. (Answer expected from those who are team capable: yes)
- To give is greater than to receive. (Answer expected from those who are team capable: yes)
- Life is often unfair, which is why the strong must help the weak. (Answer expected from those who are team capable: yes)
- I am pleased when I can help someone. (Answer expected from those who are team capable: yes)
- Everyone has strengths and weaknesses. (Answer expected from those who are team capable: yes)

Willingness to Perform (or Commitment)
People are willing to make an effort if they are either industrious by nature and consider work to be a part of life or they wish to achieve other goals by working, such as affluence or social recognition. Ambition and purpose encourage the willingness to perform well. A degree of seriousness is also necessary, however. Being focused on having fun does not bring achievements except perhaps at the beginning of a task. Over the long term, and in the degree of perfection a project may need in its details or difficulties during implementation, fun drops away and stress increases. The fun gets serious. For this reason the question personnel consultants often ask in interviews as to whether they enjoy the work is not helpful. Asking whether the applicant identifies with the work, considers it positive and engages with it would be better. Willingness to put in an effort is mostly important for the production process, for the economy.

Possible questions would be (to be answered with yes or no):

- I want to make a positive difference. Dolce Vita is not enough. I want to do something with my life. (Answer expected from those who are willing to make an effort: yes)
- Where there is a will, there is way. God helps those who help themselves. (Answer expected from those who are willing to make an effort: yes)
- No effort, no rewards. Moss grows on a rolling stone. (Answer expected from those who are willing to make an effort: yes)
- To make sure my job is secure I must make more money for my employer than I cost. (Answer expected from those who are willing to make an effort: yes)
- There should always be enjoyment. (Answer expected from those who are willing to make an effort: no)
- I don't allow myself to be taken advantage of. I have to think of myself first. Everyone does. (Answer expected from those who are willing to make an effort: no)

Integrity

When confronted with a choice between paths to take, a person has integrity if they always try to take the correct, legal path where no one is treated unjustly or harmed. We could call this fairness.

Possible questions would be (to be answered with yes or no):

- To reach sales goals your boss demands that you describe false product features to your customers. (Answer expected from those who have integrity: no)
- To reach sales goals your boss demands that you manipulate the sales figures for your department. (Answer expected from those who have integrity: no)
- Your boss wants to get rid of your colleague and demands that you make a false accusation against them. (Answer expected from those who have integrity: no)
- You are married when an attractive woman or man offers a little adventure. You would be silly to let a chance like that slip by. (Answer expected from those who have integrity: no)
- Your spouse has an auto accident and becomes crippled. Do you get a divorce, since these are new conditions under which you did not get married? (Answer expected from those who have integrity: no)

System Acceptance

Democracy and market economy conflict if there is not enough cultural acceptance for the way a market economy functions. In a democracy politics are neither capable of choosing optimal framework conditions for a market economy, nor creating policies that increase welfare through a market economy if the population does not accept it. Examples of this are a certain inequality in distribution and the basic understanding that one cannot demand more from the market than they contribute. Education about the market economy begins in schools and thus every state must be active in forming this education if it wants to make the system work. There is a lack of acceptance and understanding for market economy correlations, which explains why politics tend to disregard market economy rules and thus takes on losses in welfare.

Is system acceptance, also an attitude of employees, relevant for companies? Of course! This idea is perhaps new and thus unusual, but upon closer inspection the importance of this attitude becomes clear. We have already mentioned that many people have a highly developed sense of justice. This feeling becomes even stronger when the unequal treatment felt to be unjust is related to the respective person. The negative emotions to come from such feelings can be counter-productive for a company. If an employee finds it unfair that his boss earns double what he does, it can lead to anger and uncooperative behavior, even a refusal to perform or disobedience. The same applies for the national economic system as a whole. If a citizen rejects the system he can also refuse performance and cooperation, integration in the system; in other words he can simply refuse to participate constructively and vote for an extremist party. It is sufficient if the citizen does not understand the need to be productive and participate actively in the market economy system for this behavior to come about. If he has a passive, demanding form of thought, for example, he will demand that the state (like his parents) feed him, even if he does nothing. The same demanding attitude can of course develop in relation to a company. System acceptance requires an understanding of the system, which is where the state and companies must jump in. With the respective control questions, we can test for system understanding and acceptance in order to counter this deficit through information.

Possible questions would be:

Knowledge questions: What do you associate with market economy? What do you connect with Socialism? What are the advantages and disadvantages of a market economy?

Attitude questions (to be answered with yes or no):

Is it time for a just Socialism? (Answer expected for system acceptance: no)

Is it fair for everyone to receive what they need in life? (Answer expected for system acceptance: no)

Does earned wealth exist? Do you think the rich are entitled to their wealth? (Answer expected for system acceptance: yes)

Is your performance in the company rewarded? Is your effort worth it? (Answer expected for system acceptance: yes)

We have seen that the figures from controlling do not provide a comprehensive picture of companies. Companies should at least conduct internal surveys and publish the most important results, since soft facts are so important. This includes information on the human capital of the most important managers in the form of excerpts from their resumes. Otherwise the capital investors cannot conclusively evaluate what the consequences of poor capital allocation might be.

Technical progress forms the economy and thus the framework conditions of social existence. Thus theoretically there is not one single optimal social, political and economic order for each economic and technical stage of development with which it is possible to maximize economic productivity of the system for the good of the society. The most interesting thing we see here is that morality and economic efficiency are not contradictory. Economy can only function with people if they are at the center. Economic laws and human characteristics must both be respected, although an economy as the sum of economically relevant institutions and organizations created by people is there to serve the people. Only in this way can it be useful and justify its existence.

However, societies vary in their preferences just as individual people do. Many characteristics are part of a society's identity, with certain strengths and weaknesses that must be accepted. It would therefore not maximize benefits or satisfy needs to demand the same political and economic systems with their respective political and economic cultures from all societies. Every society must find the best path for itself. It is only important that it is conscious of the importance of qualitative factors for social welfare and that it actively implements and maintains values that support productivity balanced against other social goals.

7.3.4.5 Cultural Management, or How I Change Corporate Culture

Cultures are not clearly structured. They are ambiguous symbolic constructs, which cannot be traced to a simple cause-effect relationship, and a large part of them cannot be quanitfied because many behavioral dispositions are created in the subconscious. Cultures are not genetically inherited and not rationally learned as patterns of action, they are learned unconsciously by acting in the group. Culture is experienced through an indirect process in the group through socialization (or deculturation). To make such a process artificially repeat or to plan linearly according to a pattern appears impossible against this background. Moreover, the cultures have developed more or less spontaneously over many years. Nevertheless, they essentially consist of orientation patterns of action and values, which is why they can also be influenced. People are able to be aware of their values and norms, to reflect on them and to change them intentionally. According to Schreyögg, it is mainly about convincing organizational members that a cultural change is necessary and motivating them to try something new.[152] It has to be added that the management is responsible for implementing the company's own standards.

How is a corporate culture created? The employees contribute norms and values from outside and through cooperative work in the company. Culture acts as an institution of action.[153] The group, or more precisely the culture of the group, creates a certain pressure to adapt by sanctioning deviant behavior with exclusion and by encouraging the individual to seek the recognition of the group by adaptation. Sociology speaks of enculturation as a conscious and unconscious imitation, practice, internalization, interpretation and empathy of the individual, and of a second socialization after childhood as conscious learning and prescribing on the part of the deculturing culture. People learn and internalize corporate culture through certain roles they occupy within the group, adapting to the patterns of thinking and feeling through internalization (internalization) of the company's norms.[154]

Internalization of norms can be an adjustment in the direction of the company goals, but it does not have to. It is also conceivable that the dominant majority of the group agrees to make a harmonious environment in the company without much trouble, that is, consumption on the job. If one wants to influence the corporate culture, one has to start with the group, the dominating individuals. These are the leaders because they have the power to reward or sanction behavior. The executives are a role model because of their position. They show the employees how they must behave in order to be rewarded in the enterprise hierarchy. They are imitated to gain advantages in the company or to be generally successful, i.e. to make a career. If it is not possible to win the managers over to the cause of the company management, there is no alternative but to replace them.

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[152] See Schreyögg, Georg (1991), pp. 210.

[153] See Neuberger, Oswald/Kompa, Ain (1987), p. 62.

[154] See Berger, Peter L./Luckmann, Thomas (1972), pp. 148 and Geissler, Harald/Heidsiek, Charlotte/ Petersen, Jendrik (2010), pp. 7.

Is it allowed to influence people in the company? There are authors who reject this as a kind of manipulation.[155] Other authors see the necessity of influencing corporate culture precisely when it contradicts social morality. It is about a culture-conscious management.[156]

Here we encounter the fear that we will be brainwashing employees into automatons. The point, however, is the creation of an ethical environment in the form of corporate culture. This is more humane and leaves the individual even more freedom. A strictly hierarchical corporate organization that knows only command and obedience, is both unethical and unfree.

If one wants to change the behavior of people, one needs their willingness to do so. That means employees have to be convinced that their behavior has disadvantages for them and/or the company. Corporate culture brings many benefits as practiced behavior. The employees know how to behave and feel safe. Replacing them therefore also means taking away their sense of orientation. Furthermore, there are always advantages that an enterprise culture offers to individuals who do not want to give it up. The future cannot be assessed, which means uncertainty. A change in culture can also be associated with a loss of power for the leaders, for example, changing from authoritarian to participatory leadership[157] or preserving hierarchical levels.

According to Probst, approaches to the change of corporate cultures can be symbolized by the language, artifacts and actions. They send out signals for employees. The culture expresses itself in language, through which meanings and values are transmitted. It can be seen in the use of first names or surnames and go on to companies that give themselves their own language, more precisely words, titles or function names. In his methodology, Kant recommends using convincing examples of dutiful action to encourage virtuous behavior. Similar stories can be found in employee magazines. In a broader sense, gestures and forms of expression can be included in specific language.[158]

Guidance consists of language and actions. Language is also used to gain attention. Terms such as corporate citizenship, reputation management, corporate social responsibility (CSR) or corporate responsibility (CR) express something new, international and give the impression of an informational advantage in comparison to the old expression of corporate ethics. Corporate citizenship is now largely used in the same way as philanthropy and patronage.[159] In a survey of 443 executives in the German economy, 79.5% thought that not all CSR projects of their company were actually based on true conviction, but rather on the positive external representation.[160]

[155] So wird Ulrich Sloterdijk zitiert. See Ulrich, Peter (1984), p. 318 and Osterloh, Margit (1989), p. 153.

[156] See Schreyögg, Georg (1991), p. 207.

[157] See Schreyögg, Georg (1991), pp. 210.

[158] See Probst, Gilbert J. B. (1987), p. 100.

[159] See Lin-Hi, Nick (2014), p. 16.

[160] See Die Akademie für Führungskräfte der Wirtschaft (2012), p. 18.

Instruments for influencing corporate culture are all ethics tools, such as corporate principles and ethics seminars. However, actions express the power of the factual. No order is taken seriously if it is not implemented by acts. The actions concern all business processes and produce the results relevant to the employees, which are rewards as well as recognition (rites and ceremonies), which including the official honoring of employees (for example the employee of the month), though promotions also send signals to employees on how they should behave in order to be successful in the company.

Further instruments for influencing corporate culture are artifacts. Artifacts are bodies created by people, in the case of companies, the buildings and equipment with which the employees work. Corporate culture can support ethical behavior through the establishment of groups and meeting rooms, but also by light and friendly colors. In addition, attributes and status symbols determine the distribution of power, and thus also the distance between the employees. When a superior has the privilege of a large, valuable office, it also symbolizes distance to the subordinates and strengthens the hierarchy. If the ethics officer has a small office as an organizational tool for whistleblowing, it shows the employees that the ethical orientation is classified by the management as not so important or subordinate.[161] All measures, such as the organization of the company, the establishment of control and information systems, the allocation of employees to the offices and the distribution of business or tasks, etc., all form the broad framework of corporate culture.

7.3.4.6 Ethical Corporate Identity

The ethical corporate identity is derived from the ethical corporate culture and is intended to ensure a high level of identification of the employees with the company and with the company's goals. This is intended to increase the willingness to perform, a better working atmosphere, higher satisfaction and fewer conflicts through a higher willingness to cooperate. Externally, the corporate identity should create the image of a strong, self-confident company. An ethical corporate image thus serves the formation of an ethical corporate culture within, the ethical reputation of the company without, and creates trust among the stakeholders.[162]

Ultimately, the importance of corporate identity has decreased in the past decades, which means the internal, emotional and moral attachment of the employees to the company in particular. This has made the principal-agent problem more acute. In the past, a company's management would have been expected to work hard in the company or at least have learned about the most important value-added stages and corporate identity before being promoted. This not only had the advantage that managers could better assess the impact of their decisions on the company because they knew it, but also had a stronger identification with the company. Furthermore,

[161] See Göbel, Elisabeth (2010), pp. 226.

[162] See Balmer, John M. T./Fukukawa, Kyoko/Gray, Edmund R. (2007); Esch, Rudolf (2015) and Grabner-Kräuter, Sonja (2000).

the risk of failure due to hidden characteristics was less because the management had to prove itself in the company for many years. The principal-agent problem can ultimately only be overcome by increasing the interest alignment of agent and principle, or more generally, by promoting the identification of the agent (manager) with the company so that he becomes more of the traditional entrepreneur outlined above. However, the problems of hidden characteristics, hidden information, and hidden actions exist at every level of leadership to the subordinate decision-making units. We are therefore looking for a holistic ethical approach to management.

Corporate culture is formed mainly by the management. Leadership consists mainly of actions. At present, managers' compensation is being discussed. Both the ratio of the manager's remuneration to the remuneration of the employees at lower hierarchical levels as well as a highly variable remuneration for performance despite obvious mistakes result in negative signals for the employees.

Summary

In groups, people take on roles that influence their behavior. Groups have a group-adjusted moral behavior with their own norms. Anonymity in the group reinforces immoral behavior. It has been demonstrated with fMRI scanners that people feel negative emotions when they behave differently from the group. Corporate culture plays a key role in the success of the company. An ethical corporate culture is a competitive factor because it directly influences the cooperation of employees and therefore the added value of the organization, mainly from the division of labor, which strongly influences synergy. The leaders are first and foremost responsible for an ethical corporate culture. The values and attitudes of the employees should be recorded regularly.

As we have seen, technical progress shapes the economy and thus also the framework conditions of social existence. Thus there is not only an optimal social order suitable for every economic and technical development, but also a corresponding social and economic culture, with which one can maximize the economic productivity of the respective system for the benefit of society. Whether this optimal social culture suits the respective nation, makes it possible to achieve or is even desired, are different questions altogether. Our goal is not only the maximum economic production with the corresponding material prosperity, but the maximum human need satisfaction, thus the happiness of the people in a society. The economy here is only a means to an end. It serves man and not vice versa. We can sum up the result of our considerations as follows: Morality is of great importance where people interact with eachother to pursue a common goal, especially in the economy.

Comprehension Questions

1. Define company culture.
2. Why is company culture important for the success of a company?
3. Which values and characteristics do you consider particularly important for employees to create a productive and ethical corporate culture?
4. How can you influence company culture?

7.3.5 Ethical Leadership

Managerial powers are delegated to executives in order to implement the company's objectives. Personnel management is then the influencing of assigned employees to the achievement of the enterprise goal (**definition**).

In the field of personnel management, a "basic complementarity" between economic and social efficiency is frequently assumed as the fulfillment of employee social expectations. Krell also points to the partial conflict between the two goals. Social efficiency can often only be achieved by reducing economic efficiency.[163] Hey and Schröter demand that management ethics be designed in such a way that the employees are motivated to make their maximum contribution to the achievement of the company goal.[164]

There are two aspects of human resource management that are relevant to ethics. On the one hand, it is about the human relationship between leadership and employees, who both have as human dignity and deserve ethical protection. On the other hand, the question arises as to how far the economic efficiency is influenced by ethical behavior.

7.3.5.1 The Relationship between Management and Employees

The company hierarchy is the starting point for the management of the employees by the superiors. The superior has the right to direct his employees. This is the basis for the organizational form of companies and thus allows for efficiencies. The legitimation for this power structure is the employment contract. In this respect, the employee voluntarily agreed to comply with the instructions of the supervisor. However, there is often a dependency of the employee on the employer, since the employee is usually dependent on income from the employment contract.[165] Adam Smith was one of the first to point out this balance of power and the possible immoral consequences.[166]

Management is also dependent on the performance of the employee. Information asymmetries favor the employee, since they can deceive their superiors about their intentions and abilities and deny information within the company. In turn, the executive has exclusive knowledge not known to the employee (asymmetrical information).[167]

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[163] See Krell, Gertraude (1999), p. 342.

[164] See Hey, Dieter/Schröter, Armin (1985), p. 31.

[165] See Wittmann, Stephan (1998), p. 196.

[166] See Smith, Adam (1993), pp. 58.

[167] See Göbel, Elisabeth (2010), p. 194.

The employer depends on the loyalty of its employees because it cannot force employees to use their full productivity or to fully monitor and sanction their behavior.[168]

Employees are also ethically committed to their employer. They are obliged to use him and not to harm him. This is called loyalty. Both parties have entered into an unofficial loyalty agreement. Firstly, they have to provide their labor to the employer, which means, for example, that no “consumption on the job”[169] is carried out through excessive private telephone calls. Important information must be handed over to the employer and an honest co-operation applies to both the employer and the employee. The employer’s property must be respected. The interests of the employer are to be represented objectively, which excludes advantage, from bribery, and by lying such as faking illness (integrity).

Ethical obligations arise towards the colleagues, both from the employment contract and the fact that they are humans. Here, too, colleagues are to be treated with respect in particular, not to be ganged up on. The team approach requires open, honest communication, a good working environment and mutual support.

The inconsistency of employers can generate dilemmas for their employees. For example, they promote competition among the employees in order to increase productivity, but also demand full cooperation within the framework of teamwork. If employees report mistakes, they often face reprisals. Constructive criticism is not desired. If employees reveal errors to executives, it is often to their disadvantage.[170]

Apart from the obligation to work, the legislature usually prescribes other duties of the employees. They must preserve secrecy about business secrets; they must not make any reputation-damaging or credit-damaging statements. For example in Germany, they may not harm the employer through competition and are obliged to obedience (§ 241 II BGB). They are, for example, obliged to warn the employer of imminent damage.[171]

Rolling Game: The Ethical Responsibility of the Employer

You are a personnel manager, you will learn about emotions present in a critical staff discussion: Inform the employee about his dismissal.

1. Situation of the employer: The product line of tableware goes to Romania. The employee is to incorporate the Romanians before he is released.
2. Situation Employee, of age 40, has been with the company for 16 years. He has a mortgage and 3 children (1, 3 and 6 years). His wife does not work.

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[168] See Richter, Manfred (1994), pp. 15.

[169] See Göbel, Elisabeth (2010), p. 201.

[170] See Göbel, Elisabeth (2010), p. 202.

[171] See also “Treu und Glauben” (good faith) § 242 BGB, http://wirtschaftslexikon.gabler.de/Definition/fuersorgepflicht.html?referenceKeywordName=Schutzpflichten+im+Arbeitsverh%C3%A4ltnis and http://wirtschaftslexikon.gabler.de/Definition/treuepflicht-des-arbeitnehmers.html (19.09.2012).

Moral Justification Strategies

In the above situation, you were forced to harm someone else, to behave non-ethically. How did you cope with the situation? How did you justify your behavior?

This was an ethical dilemma situation. You had the choice to do your job and harm the others or refuse the order. Refusal would have been a reason for dismissal or demotion and you would have damaged yourself. Often we tend to justify our behavior to ourselves in such a situation. In this case, the employer could say:

1. "If I don't do it, someone else will." (Relativity of responsibility)
2. "I need to think about my family." (Change of balance by increasing one's own damage). This is moral self-protection, which can also be abused. One wishes to preserve one's self-esteem, but the consequences of ethics can ultimately determine the result of the moral evaluation. These are called neutralization strategies.

Other common neutralization strategies are:

3. "It was an accident!"
4. "Others are guilty" (stating their own responsibility),
5. "This is not so bad!" Or "I've only borrowed it." (Relativization of the damage),
6. "He deserved it." (Reduction of the sacrifice),
7. "Anyone would have behaved this way." Or "They would have done it." (Depreciation of the other or of the condemned).[172]

The last form of the neutralization strategy is particularly applicable to an unethical corporate culture. Here, however, the danger presented by ethical ethics as an appraisal is also shown by the fact that it is responsible for the immoral behavior not the individual, but the state of affairs, which is sufficiently ethically regulated and can therefore be used by the individual as a neutralization strategy.

Behavioral Standards for Leadership

The employees are a production factor of the enterprise and the economy. Are they just a means of achieving the goal of maximizing profit? In his categorical imperative Kant asks not only to treat man as a means, but also as an end, that is, as a man with his own dignity.[173]

The following norms for dealing with supervisors and employees can be found in the literature of ethics[174]:

1. Respectful relationship with each other, without harassment, insult, degradation or sexual harassment

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[172] See Sykes, Gresham M./Matza, David (1957), pp. 667.

[173] See Kant, Immanuel (1797a), (C), p. 429.

[174] See Ulrich, Peter (1999), pp. 238 and Lay, Rupert (1989), pp. 140 zu den Grundsätzen der Führungsethik.

2. No discrimination, in particular, no unequal treatment in terms of promotion and payment and recruitment
3. Protection of privacy, acceptance of conscience, respect for dignity and freedom of employees, protection of personal data
4. Protection of health, particularly human work relationships

The following “meritorial duties” for the superior are derived from Kant[175]:

1. Communication among equals, rather than command and obedience
2. Explanation and honest information
3. Praise and blame (as constructive criticism)
4. Empathy and support

Working conditions should be “encouraging”:

1. Purposeful tasks with a variety of requirements
2. Scope of action, thus also self-responsibility and freedom for personal development
3. Possibilities for social interaction
4. Development options for the employee

The fact that the situation is different in reality is due, on the one hand, to the lack of knowledge about rights and obligations and, on the other hand, to the dependence of many employees on their employer. There is still unpaid overtime, the exploitation of unorganized workers, through temporary work and work contracts, surveillance and control through cameras, bullying and the prevention of the formation of employee organization.

Executives can demand immoral actions from their employees to increase profits. Such instructions are not legitimized by the employment contract, but there are always such immoral instructions that the employees follow, because they feel they cannot refuse their superior.

Balancing consequences must take place precisely at the management level. The profit does not justify any means with damaging consequences for others. The supervisors bear a special responsibility for their actions, as the employees need them in many areas and their behavior directly affects the employees and third parties. Power is therefore the ability to produce other consequences.[176]

Such unethical behavior can, however, be in the interest of the company at least in the immediate term. Managers often seem to fall into the argument that they are forced to act in the interests of shareholders and immoral employees to maximize profits.[177] They then have no guilty conscience and feel protected by the company in the event that their misconduct is disclosed.

[175] See Kant, Immanuel (1797a), pp. 13 and Göbel, Elisabeth (2010), p. 195.

[176] See Ulrich, Werner (1980) and Göbel, Elisabeth (2010), p. 200.

[177] See Gellerman, Saul W. (1986), pp. 88.

Summary
The executive has a special responsibility to his employees. There is a mutual loyalty obligation and an unofficial loyalty contract based on mutual trust. An ethical weighing-up of the action sequences must take place, in the case of leadership. A superior who orders a crime is punishable; likewise, the employee who performs a crime is also responsible. At best, there is a penalty reduction if there is a strong co-dependency on the executive.

Comprehension Questions
1. What is the interdependence between management and employees?
2. What is an unofficial loyalty contract?
3. What is the duty of the employer to be a member of the employer's liability and therefore also the managerial power?

7.3.5.2 Leadership Styles

It is true that the concept of leadership styles is controversial. The concepts cannot be clearly delineated and the style depends on the personality of the executive and the situation.[178] Nevertheless, there are hardly any alternatives to define the directions for optimal handling of employees.

There are many different approaches, which differ essentially by the involvement of employees in the decision-making process. We want to summarize the various management concepts into three types. Lewin distinguishes leadership styles as authoritarian (also hierarchical), democratic (also cooperative) or laissez faire.[179]

Authoritarian Leadership
Leadership gives instructions as commands without involving the employees in the decision-making process. It also does not explain the decisions or tasks. It retains the information and the reasons for the decision (therefore autocratic leadership style). There is a great personal distance between management and employees, which is why we speak of hierarchical leadership. If the instructions are not carried out or are incorrectly executed, the management reacts with sanctions. Praise is rare.

The advantage of this style of leadership is that it can be implemented quickly, without explanations, discussions or contradictions. This is why it is used mainly in the military. It also enables the management of less qualified employees, but requires intensive control and a high level of expertise from the manager. As a result, the decisions are very much dependent on the supervisor, which is why this style is preferred by managers who do not shy away from force. Conversely, this style of leadership is less motivating, since the employees do not feel personally addressed and do not know the background of their work or task. The competences of the

[178] See Rost, Joseph Clarence (1993), pp. 17.

[179] See Lewin, Kurt/Lippitt, Ronald/White, Ralph K. (1939a, b), p. 271.

employees is limited and their information is not of value, which means that the risk of making incorrect decisions is higher.

Cooperative Leadership Style
In the case of cooperative management, the employee is integrated into the decision-making process by the manager, thus it is also called democratic or participatory style. This makes the employee more motivated, but the decision-making process takes longer. In the case of errors, the employee is not directly punished, but supported. The disadvantages of the authoritarian style of leadership are the advantage of the democratic leadership style and vice versa. The potential of the employee can be better used for the benefit of management and employees. The risk of incorrect decisions is reduced by including the competence and knowledge of the employee. The working environment is improved by cooperation and the associated recognition of the employee. However, employees and leadership must be more qualified for this type of leadership style.

Laissez-Faire Style
This style of leadership, or free-reign style, is characterized by maximum freedom for the employee. The leadership does not interfere and delegates work decisions, the organization of procedures and their implementation to the employee. This approach is used in creative departments, such as the fashion sector. This approach is characterized by non-leadership, so it is not a leadership approach in the narrow sense.

Lewin, Lippit and White analyzed the influence of these three different leadership styles on the employees and their performance. In their study the autocratic style led to high performance in the short-term but also led to negative feelings. In contrast, the democratic style created positive feelings for team members but resulted in lower performance.[180]

There are many other leadership concepts. Daniel Katz and Robert L. Kahn distinguish between production-oriented behavior and relationship-oriented behavior as a leading style. Already Katz and Kahn assumed that an employee-oriented management style with a high level of satisfaction also increased the performance of the employees.[181] Robert R. Blake and Jane Mouton distinguish five leadership styles according to the different characteristics in the areas of task orientation and personal orientation. This results in different styles with varying or weak expressions of the two dimensions. Hersey and Blanchard extend these dimensions by incorporating the maturity of the employee, resulting in four leadership styles. The lower the personal maturity and education of the employee, the higher the task orientation, which in the extreme becomes the authoritarian leadership style. This is followed by an integrated management style for more mature employees. In the case of an above-

[180] See Lewin, K.; Lippit, R. & White's, R. (1939a, b) and Abu-Hussain, Jamal (2014).

[181] "A worker who perceives management as interested exclusively in cutting costs and getting maximum production at the least costs possible may easily conclude that the union organization offers a better means for the protection of his interests." Katz, Daniel/Kahn, Robert L. (1952), p. 652.

average maturity, a relationship-orientated style then becomes a participatory style and at the extreme maturity of the employee a delegational style.[182] There are two important aspects of leading in organizations: one is to emphasize that protecting the interests of the organization is the duty of the members and the second is to deal with the needs of the team members to have them doing extra efforts voluntarily. In the managerial grid approach of Blake and Mouton the ideal leader is the one who combines both aspects with the highest score from task orientation and human relation orientation.[183]

7.3.5.3 Leadership Theories

There are theories about the best method of leadership. In the 1950s the so called “great man theory” was the decisive leadership theory. It stressed special traits of a leader as a prerequisite to influence members. Leadership is accepted based on the character of the leader.[184] Because it was difficult to determine the appropriate traits, later research focused on the specific behavior of leaders, which was called the behavioral approach. The behavior was dependent on the situation, which led to the situational approach.[185] Later the approaches analyzed the variables which determine the effectiveness of leadership in organizations with reference to the members. The outcome was the transactional and the transformational leadership theories. Current research is still scrutinizing the effect of leader behavior and traits on employee’s performance and can be divided in a more quantitative cost and benefit approach of influencing the followers and a more qualitative relationship oriented approach.[186]

Transactional Leadership

Transactional leadership (path goal theory of leadership)[187] is guiding with goal agreements. This approach is based on the expectation-valence theory. Performance should be stimulated by an expected reward. The basic assumption is a contract approach. The employee has the expectation, from his employment contract, of exchanging performance for reward. It leads to a management-by-exceptions where the leader has to monitor the performance of the members and has to sanction and reward according to their performance.[188]

As a special form of the target-oriented transactional style, one can lead through existential coercion. This concept is known as the up-or-out concept is currently widely used. It is set as a reward and sanction system by the company management.

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[182] See Hersey, Paul/Blanchard, Kenneth H. (1993).

[183] See Blake, R. R. & Mouton, J. S. (1964a, b) and Abu-Hussain, Jamal (2014), p. 1268.

[184] See Stogdill, R. M. (1948) and Abu-Hussain, Jamal (2014), p. 1268.

[185] See Wren, D. (2005) and Abu-Hussain, Jamal (2014), p. 1268.

[186] See Abu-Hussain. Jamal (2014), p. 1268.

[187] See Downtown, James (1973) and Bass, Bernhard M. (1985).

[188] See Abu-Hussain, Jamal (2014), pp. 1269.

Up-or-out means that the employee must leave the company if he does not reach the targets. This concept superimposes all other forms of leadership styles through uncompromising standards. The individual supervisor cannot meet this requirement using their own style.

The up-and-out leadership concept goes back to Jack Welch, General Electric's CEO. One of his most controversial rules was the 20–70-10 formula, or the rule of stars and lemons. The best 20% of the management, the stars, were rewarded with lush bonuses, the broad center was still supported and the weakest 10% were made redundant as so-called lemons.[189] This rule also applied to the leadership of Skillings, Enron's CEO. In the Enron case, two factors are related: a non-human-oriented management of the employees and an extremely short-term-oriented success measurement of the employees combined with draconian sanctions. How should an employee react when he knows that he loses his job if he does not reach a profit of X by the end of the quarter?

Can you force performance? Certainly performance and commitment sometimes also need some pressure, but too much of it has a counterproductive effect. Even a competent and efficient employee cannot achieve success against the market. They must have competitive products that meet the needs of demand. A short-term success measurement has a counter-productive effect when most of the successful business processes are long-term. The same applies to the risk-adequate remuneration. If the specifications are incorrect, the employee cannot work optimally. If measured at the end of the quarter, he cannot build anything for 2 years and thus productive forces cannot unfold.

How should an employee react when he knows that he loses his job if he does not reach a profit of X by the end of the quarter? Can performance be enforced? Is loyalty unilateral to the employer? Under such conditions, the employee can no longer behave loyally to the company and advise clients objectively. A bank employee, for example, cannot advise customers to their advantage in the long term if he has to sell several products for this customer every quarter. Instead of selling when the customers experience a need, he is forced to sell the customer products that they don't need to reach quotas. The employee has to think about himself. He cannot afford to be fired at the end of the quarter. To a certain extent, he has to work against the company. If the figures are not achievable because they are disproportionate, there is great incentive to manipulate them and the employee has less of a guilty conscience than if they had been proportionate.

At Enron, not only did the employees work against each other but the management worked against the employees. The result was that the employees also worked against the management and thus against the company. Management did not involve employees as people in the company, but put them under pressure. The employees were thus not motivated and were unable to work independently for the benefit of the company. Skilling created a climate of fear among his employees. If he saw that an employee did not deliver the expected performance, they could count on their dismissal. But he could not control them and did not know what was going on in his

[189] See Ridderbusch, Katja (2010).

company. He had little interst in why permance was lacking. He did not care about the employees, which is why he did not include them in the company process either. Independent, constructive, decentralized action did not occur. Rather, the employees tried to blind the management with misinformation and eliminate their colleagues. The management was shown a successful pseudo-world, and whoever was best was promoted most. In the end, a climate of falsehood, fear and recklessness arose as a consequence of an unproductive business process.

For clarity, a recent study by the University of Hamburg is quoted here. The research group surveyed nearly 650 employees from various companies about what is important to them in their work. The result may be surprising. Most of the employees said that a respectful employer is more important to them than a safe place, good pay or a great career. If the executives do not treat their employees respectfully, employee commitment decreases and they are then more independent. If they are treated with disrespect, it is hard for them to respect their boss and follow his instructions. This can go so far as to cease independent thinking and only make "service according to regulation," thus they internally check out.[190]

Transformational Leadership

In the case of the management style concepts or theories, the approach of the transformational leadership emerges from an ethical point of view. This approach emphasizes the importance of leadership as a model. Burns emphasizes the importance of positive role models referring to political leaders, "leaders and followers make each other advance to a higher level of morality and motivation."[191] "Transformational" is the approach because it wants to positively transform the behavior of the employee through the exemplary behavior of the executives and the creation of a trust base. According to this approach, the motivation and the behavior of employees can be influenced better by the positive example of the supervisor than by traditional methods.[192] The transformational leader addresses the intrinsic needs of the employees which are on a higher level of the Maslow's Hierachy of needs turning to values and ideals like freedom, justice, equality, peace, humanitarianism. Base feelings like fear, greed, hatred or envy are not used to enhance performance.[193] Bass supplemented Burns' approach by stressing the motivation of the employees to achieve the company's goals as an important task. A leader has to convince the employees that the team or company result is dependent on them and is of more importance than some of their own interests. Leaders therefore should be also charismatic in order to inspire their followers with visions and team spirit.[194] The transformational leader will create a shared interest that unites leader and followers to increase a company's performance. If he has to punish them he will never decrease the follower's belief in his self-efficiency but try to help him personally to perform better next time.

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[190] See Handelsblatt dated February 15th 2007, p. 10.

[191] Burns, J.M, (1978).

[192] See Pelz, Waldemar (2014) and Pelz, Waldemar (2015).

[193] See Abu-Hussain, Jamal (2014), p. 1270.

[194] See Bass, B.M. (1985) and Abu-Hussain, Jamal (2014), p. 1270.

Therefore transformational leadership requires a high moral and ethical development of the leader.[195]

Hebert's research shows the importance of emotional intelligence to address the employees personally.[196] Using data from the units of a regional restaurant chain via employee surveys, manager surveys, customer surveys, and organizational records, Koys shows that employee satisfaction, organizational citizenship behavior, and employee turnover influence profitability and customer satisfaction. Cross-lagged regression analyses show that employee attitudes and behaviors are related to organizational effectiveness.[197] A meta-analytic review of 25 years of research showed a positive correlation between transformational leadership and the performance of the workers not only at an individual level but also between transformational leadership and team and organizational performance.[198] There are also studies which compare the influence of transformational leadership with the influence of transactional leadership on company's performance. A study of Deluga shows that leader efficiency and employee satisfaction are more linked to transformational than to transactional leadership.[199] Effectiveness and innovation of organizations seem to be enhanced more by transformational leadership than by transactional leadership.[200]

Surveys about the influence of ethical leadership add to the picture. Empirical surveys showed that employees are more likely to be influenced by ethical management.[201] The integrity of leadership and the influence of the subordinates are positively correlated. As a leadership property, altruism, trust, politeness and cooperativeness were identified as the most important prerequisite for the influence of leadership.[202] Empirically, Seidel was able to demonstrate in the context of a meta-analysis that the cooperative leadership is tendentially superior to the directive leadership with creative and innovative tasks, but not for the management of routine tasks.[203]

It is thus shown that an ethical style of leadership is more effective than others. The following quotation sums up the conclusion:

> "Effective leaders take a personal interest in the long-term development of their employees, and they use tact and other social skills to encourage employees to achieve their best. It isn't about being "nice" or "understanding"- it's about tapping into individual motivations in the interest of furthering an organization-wide goal."[204]

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[195] See Bass,B. (1999); Popper, M. (1994) and Abu-Hussain, Jamal (2014), p. 1270.

[196] See Hebert, E. (2011).

[197] See Koys, D. J. (2001).

[198] See Wang, G. & Oh, I.S., Courtright, S. (2011).

[199] See Deluga, R. J. (1988).

[200] See Lowe, K., Kroeck, G. & Sivasubramaniam, N. (1996) and Abu-Hussain, Jamal (2014), pp. 1270.

[201] See Turner, N./Barling, J./Epitropaki, O./Butcher, V./Milner, C. (2002).

[202] Like a sub-characteristic of "agreeableness". See Judge, T. A./Bono, J. E. (2000), p. 760 and Brown, M. E./Treviño, L. K. (2006), p. 603.

[203] See Seidel, Eberhard (1978).

[204] Prentice, W.C.H. (2004), p. 102.

The modern, meaning-oriented concept of management addresses a person's need for meaning in life and tries to give the employees meaning through their work and thus also a motivation to get involved with the company. The sense-oriented style of leadership goes back to Plato, who saw in the logos, that is, the sense, the correct orientation for guidance.[205]

7.3.5.4 Leadership Authority

Leaders need authority in order to get employees to follow their orders. It is the basis for recognition of the superiors as leaders. Authority is a prerequisite for leadership. Here one differentiates traditionally into three forms of authority[206]:

1. **Official authority: conduct thanks to the power of the office**

The office position is awarded by the company. It is entitled to give the employees instructions, which they must implement according to their employment contract. Whether they want this is a completely different question. The boss nowadays receives less and less respect for titles and positions. Official authority alone is not sufficient. If a supervisor relies only on the authority of his position, it is often similar to an authoritarian style of leadership, which leads to management problems. The more a supervisor appeals to his official authority, the more difficult his leadership becomes in the form of conflicts and authority crises. Necessary cooperation is made more difficult. Employees increasingly want to be seen as individualists and equal partners, not to feel themselves as subjects.

2. **Expertise authority: Leadership due to the development of knowledge**

Employees recognize leadership because the supervisor has more expertise and knowledge than they do. Due to the high specialization, this is less and less the responsibility of the management. However, it is unbearable for the employee if he is to implement the factually incorrect instructions of his superior and thus harm the company. The employees want to work productively, not destructively. The supervisor is then not taken seriously. The employees ask other employees for information, which weakens the management. Others are quickly aware of the lack in knowledge of the supervisor and the manager loses the information exchange with his employee.

3. **Personal authority: Lead through trust and conviction through personality and role model**

This is where the ethical leadership takes place.[207] The supervisor is credible in his or her personality and can motivate the employees, to work on a task for the company. For this, it is important that the supervisor is an example. The employees

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[205] See Mascha, Andreas (2013).

[206] See auch www.personaltraining-kratz.de/.../muessen_vorgesetzte_autoritaet_besitzen (20.06.2015).

[207] See Lay, Rupert (1989), pp. 147.

can trust him and accept him as a role model. Even without the backing of the company the employees in a group would choose him voluntarily as a group representative and group judge. An official authority is not required. Even in the absence of the superior, employees try to advance the task or their work. They need not be forced and supervised. For this, it is necessary that the employees are not only treated fairly by the supervisor but also feel represented in key interests. The management force must consider the employees as a partner without prejudice and arrogance, and also to communicate and treat them accordingly.

Therefore, the executive should actively involve the employees in the process of forming the will within their area of competence and use them according to their abilities, knowledge and experience. In order to understand the employees and not to overburden them with the assigned tasks it is necessary that the manager not only keep their ears open for the concerns of the employees, but also listen to them and even show some emotions, like compassion. The manager must be a role model for the employees in personal behavior. A leader cannot ask of their lower paid employees what they would not do themselves. Loyalty is not a one-way street. Privileges and disproportionately high pay in relation to work, training and risk lead to less motivation and even envy among the employees. It is not felt to be just.

Humanity and authority can be shown by the fact that leadership confesses its own mistakes. Management should show self-confidence through calm, even in difficult situations, and by empowering employees to strengthen their self-confidence. This includes delegating tasks to employees and giving them competencies and decision-making facilities. Criticism should always be objective and not personal. The criticism must be understood by the employee. The leadership tool of acknowledgement should outweigh criticism and strengthen the employee's self-confidence. This is then also projected back to the management by the employee. Otherwise, the executive would have made a mistake by overburdening the employee.

At the very least, management needs so much expertise that it does not make any mistakes that are obvious to the employees. Decisions should be consistent and without hesitation if possible; on the other hand, the decisions should also be weighed and reflected so that a negative outcome cannot be attributed to a mistake. Leadership must be recognizable and the delegation weighed, so that it does not give the impression that leadership wanted to avoid work or decision making. Too much delegation is interpreted as a weakness of leadership by many employees as well as exaggerated fraternization. Benefits and cooperation, to which the employees are legally and morally obligated as part of their employment relationship, must not demanded by the supervisor.

In turn, the employee expects to be treated fairly. A pure command and obedience principle, that is, the treatment of the employees as subordinates, is not an objective here. It is also counterproductive to use the information monopoly, the exploitation of the power of information and power of the executive. The employee does not feel treated as an equal but rather marginalized. Dishonesty and manipulation are the opposite of personal authority. If management tries to vie with one another through intrigue or unfair praise and criticism, in order to gain a position of strength against the group, he provokes constant conflict among the employees and a bad business climate, as well as a strong disregard, distrust and feelings of revenge on the part of the employees.[208]

It should be noted that all three forms of authority must be used for successful management of the personnel staff. Without executive authority, that is, without the powers of a leadership position, a leader can not reward and sanction, and thus cannot lead. With only a minimum of expertise, a leader can not make the right decisions and loses recognition among the employees. The executive is unable to evaluate the information that the employees have passed on to them, and aggregate them in the management hierarchy. However, if personal authority is missing, it means that the employee does not accept the personality of the executive, and rejects objectively correct orders only because they are based on this leadership. The employee executes the instructions only reluctantly, against his own will. He is then not only unmotivated to carry out the instructions, but it saps him of strength to perform them against his own will. To suppress his inner resistance to his superiors and not to "shout loudly," the employee loses energy and thus productivity. Against this background, internal termination is only the first step. He will want to retaliate against the executive for this emotional damage. This may result in denying important information to the manager or denunciation of his superior.

According to executives, the motivating effect of salary and other material incentives will decrease in the future. Instead, the motivation and personal commitment of the employees is to be achieved more with appreciation, individual decision-making and self-responsibility. Status symbols become unimportant. Rather, autonomy and the perceived meaning of an activity determine the degree of operational readiness.[209]

Empirical studies on the leadership style of German managers are somewhat contradictory and reflect different attitudes and internal contradictions among the managers. According to a study that surveyed 400 German executives, most executives agree that hierarchical leadership is no longer appropriate because of the complexity and dynamics of the future world of work. The suitability of success-enhancing management tools such as goal management and controlling is reduced by increasing volatility and decreasing planning. According to another study in Germany, the leadership style still dominates for key figures with the aim of maximizing the return on capital (29.5% of the 400 managers interviewed).[210] According to their own perceptions, only 13.5% of the 400 executives surveyed take the lead in terms

[208] See auch www.personaltraining-kratz.de/.../muessen_vorgesetzte_autoritaet_besitzen (20.06.2015).

[209] See Initiative Neue Qualität der Arbeit (2012), p. 9.

[210] See Initiative Neue Qualität der Arbeit (2012), p. 7, 12.

of personnel security.[211] However, the majority of German top managers[212] say that in their opinion the most important is personality authority and only about 12% expertise authority. Thirdly, democratic authority comes from the involvement of the employees, team thought and a participatory management understanding. On the other hand, purely official authority is rejected. Two-thirds emphasize that in particular the authentic past actions and credibility constitute a legitimate source of authority. The opinion of a chairman of the Board of Managing Directors is characteristic: “Personality authority means that one can inspire peopl... this is achieved by a manager only if he demonstrates his own moral values credibly.”[213] There is a contradiction in business ethics and practical implementation. Although many companies are characterized by ethical principles, they are always violating moral priciples.[214]

Summary

It is true that the concept of leadership styles is controversial, especially because the concepts cannot be clearly delineated. The style also depends on the personality of the executive as well as the situation. Nevertheless, there are hardly any alternatives to define the directions for optimal handling of employees. Only the democratic or cooperative style of leadership is appropriate for taking full account of ethical aspects in decision-making; it involves the employees in the formation of opinions along with their information and interests. The transformational style of leadership tries to gain greater influence on the employees through ethical leadership. In the case of those in authority, the personality authority is suitable to motivate the employees ethically.

Comprehension Questions

1. Identify and explain the leadership styles presented.
2. Name and explain the authority types presented.
3. Which management styles and types of authority do you consider appropriate for a medium-sized German company? Explain your choice.

[211] “Good leadership is authentic, competent and possesses natural authority. Loyalty and satisfaction of the employees are the result of a personal role model and the assumption of responsibility.”. Initiative Neue Qualität der Arbeit (2012), p. 12. 15.5% of the 400 executives surveyed agreed on the democratic leadership style, which was intended to compensate stakeholder interests, 24% saw their main management task in the hierarchical network of the employees in the company and 17.75% in the coaching of teamwork. See Initiative Neue Qualität der Arbeit (2012), p. 13.

[212] Part of the survey were top executives who held the position of Chairman of the Board of Management, Chairman of the Supervisory Board or a member of the Executive Board in the 100 largest companies in Germany (in 2000).

[213] Quoted after Buß, Eugen (2009), p. 9.

[214] See Buß, Eugen (2009), pp.11.

7.3.6 The Ethical Model of Company Management

Moral behavior is important for every company. Immoral behavior reduces economic efficiency. Moral in this context means that the employees act for the good of the company, they benefit the company. It has long been considered obvious that employees should be loyal to their companies, but with the unscrupulous enrichment of managers in the recent company crises, this fact seems to have been somewhat forgotten. As we have already mentioned, a company is dependent on its employees to put the interests of the company before their own, at least while working. The employees must dedicate themselves completely to the company productivity and act loyally, as they can permanently damage the company if they do not. Employees are often entrusted with company information pertinent to competition and valuable company inventory. Moral behavior amongst colleagues is also to be expected from employees. Only when the employees are open and fair with one another is a cooperative effort and thus a common added value achievable. If the employees do not act morally, their supervisors can no longer rely on the information passed on to them or their performance. If the employees manipulate their success or the success of others, such as was the case at Enron, the managers cannot get the most out the employees.

The employees at Enron not only worked against each other, but the management also worked against the employees. The result was that the employees worked against the management as well, and thus against the company. The management did not include the employees as people in the company, but placed them under pressure. They were thus not motivated and not capable of working independently for the good of the company. Skillings created a climate of fear among the employees. Whenever an employee did not provide the performance expected, he could expect to be dismissed. Skillings was unable to control them, however. He did not know what was really happening in his company. He did not seem interested in knowing why the performance was not sufficient, and did not identify with the employees, which is why they did not include him in the company process. There was no independent, constructive, decentralized action. It was much more the case that the employees tried to blind management with false information and to get a leg up on their colleagues. The management was successfully shown an illusory world, and whoever could blind the most ingeniously got ahead. All of this created a climate of falseness, fear and ruthlessness, the consequence of which was an unproductive company process.

In the case of Enron two factors come together. One factor was an employee management not attuned to the people involved, and the other was measurement of employee success on an extremely short time interval connected to draconian penalties. How should an employee react when he knows that he will lose his job if does not achieve X amount of profit by the end of the quarter? Is it possible to force performance? Surely the required performance sometimes needs a certain degree of pressure, but too much is counterproductive. Even a competent and hard-working employee cannot create a success contrary to the market. He must have a competitive product that can find a demand with purchasing power. A short-term measurement of success has a counterproductive effect when most successful company processes are long term. When the parameters are wrong, the employees cannot work optimally. When they are judged at the end of the quarter they cannot build something up over 2 years, and their productive forces cannot develop.

Under these conditions the employees are no longer loyal to the company, and must think of themselves first. They cannot afford to be dismissed at the end of the quarter and must work against the interests of the company to a certain extent. A bank employee cannot advise the customer in the customer's best interest for buying stocks if he must sell the customer more products each quarter. He cannot make a sale when the customer has a need, he is forced to sell things to the customer that are not needed.

7.3.6.1 Virtue or Individual Ethics: What Should Be the Characteristics of an Optimal Management?

Group work with presentation: Characteristics of an optimal leadership

What are the character traits of optimal leadership? Explain your position.

What are the character traits of optimal leadership? Should it be positive characteristics, defined as practiced and internalized dispositions to do good, dispositions to behave morally? Or are characteristics such as enforcement, hardness, recklessness and cleverness more important?

Dissatisfaction of the employees with management forces leads to a loss in productivity and increase of costs. For example, in 2014, a survey of 2687 employees and executives in Switzerland showed that 62% of the interviewees had already resigned because of a conflict with a superior. In a comparable survey in Germany in 2013, 50% of respondents said that they had resigned because of a superior and an additional 20% said they were about to quit.[215] The effects of unethical behavior of superiors and the effects on productivity can also be demonstrated by the example of ENRON. If the company treats the employees very badly, the loyalty contract is canceled. First comes the internal termination and then the employees try to defend themselves or compensate for the disadvantages by working against the interests of the company.

The following characteristics expected from ethically oriented leadership are found in the pertinent literature.[216] The four cardinal virtues are:

1. Wisdom and courage for truth (Plato, Socrates)

The ability to recognize reality and the ability to determine morally good behavior while weighing the consequences (goods) in every situation.

2. Justice (Aristotle)

[215] See Information Factory (2014), p. 4.

[216] See Kiefer, Heinz J. (1985), pp. 69 and Schmidt, Walter (1986), pp. 40.

The acceptance of the rights of others (tolerance) and the will to enforce these rights while weighing all the consequences for those concerned.

3. Bravery (conflict, civil courage) (Plato, Socrates)

The readiness to stand up for justice (the good) while accepting one's own disadvantages. Perseverance and endurance are also added here.

4. Mindfulness, moderation (Plato)

The opposite of greed. Greed precludes wisdom and prudence as prerequisites in making prosperous choices for oneself and others. Humility and modesty are included in mindfulness and moderation.

Other important properties are:

5. Altruism (compassion, benevolence)

The will to do good.

6. Loyalty, honesty and exemplary behavior

As far as human resource management is concerned, we have found that ethical behavior of executives increases their authority. Empirical studies have also shown that the exemplary leadership or good leadership perceived by the subordinates is correlated with the attributes of integrity, honesty, and trustworthiness.[217] Summarizing the results of the various surveys, ethical leadership is characterized by the employee as being honest, caring, just, promoting ethical standards and ethical education through reward and sanction and exemplary behavior.[218]

The managers are above all role models for the employees. The importance of the behavior of managers seems to be underestimated in the literature and in practice they have far more influence on the behavior of employees than is generally assumed.[219] There is a definition of leadership ethics that takes this into account:

> "the demonstration of normatively appropriate conduct through personal actions and interpersonal relationships, and the promotion of such conduct to followers through two-way communication, reinforcement, and decision-making".[220]

It must be emphasized that an ethical leadership style is not limited to ethical behavior, but rather postulates ethical values acts as a role model and rewards ethical behavior and sanctions violations. Empirical studies show that ethical leadership is primarily associated with fairness and honesty.[221] Ethical leadership also leads to

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[217] See Kirkpatrick, p. A./Locke, E. A. (1991); Den Hartog, D. N./House, R. J./Hanges, P. J., Ruiz-Quintanilla, p. A./Dorfman, P. W. (1999) and Brown, M. E./Treviño, L. K. (2006).

[218] See Brown, M. E./Treviño, L. K. (2006), p. 597.

[219] See Schieffer, Alexander (1998), p. 242.

[220] See Brown, M. E./Treviño, L. K./Harrison, D. (2005), p. 120.

[221] See Bass, B. M.,/Avolio, B. J. (2000) and Brown, M. E./Treviño, L. K. (2006), p. 597.

a commitment to engage at an above-average level in the job (extra effort) and a willingness to report problems to the management.[222]

According to the theory of social learning, people emulate behaviors when the role models are in a socially elevated position. The power and status of the superiors are attractive and act as an incentive to copy their behavior. Ethical behavior must therefore also be taken into account in the case of promotions. Added to this is the credibility of the role played. If the model does not follow the ethical guidelines, it would be irrational to think the employee would.[223]

The saying "bad examples spoil the customs" applies both internally within a company as well as economically. Others will see that it pays to enrich themselves at the expense of the company or other economic operators and will emulate that. The top manager, who has become rich through the sale of his stock options, although he has harmed the company entrusted to him, will also find imitators as corrupt buyers. If this damaging behavior is not sanctioned, honesty would be stupid because it does not pay off. Moral decline of the supervisors not only harms the companies or individuals, but also the system as a whole.

Rewards and sanctions are signals, the rewards are positive motivating examples, and the sanctions are fear-based examples. Even the unwarranted enrichment of a top manager sets a signal, a "model": If a higher-ranking boss does not have to strive to achieve above-average achievements through honest hard work, how can one then demand this from a much lower salaried employee? What would this mean for a company culture and what would the performance be if all employees were to behave like this? Immorality pays off. Loyalty, morals and honest work are devalued with such a remuneration, which greatly reduces the motivation to behave cooperatively and to work productively. If such behavior is allowed, this would not only be economically system-destructive, but also civilizationally backward. A democracy builds on certain values and principles, which are understood by society as the "contract sociale." Égalité, fraternité and liberté also include a minimum of equality of opportunity. A publicly tolerated unjust enrichment should not only contradict these principles, but also provoke envy and thus threaten social consensus (peace).

7.3.6.2 How Can We Motivate Employees to Adopt Ethical Behavior?

Ethical corporate governance and goals alone are not enough to ensure ethical behavior. In addition, the behavior of employees must be ethically motivated and controlled. Numerous ethical instruments are available to motivate employees. The most common is compensation (salary, stock options, profit sharing) or transportation. In addition to these material rewards, there are still intangible rewards such as praise and recognition, status, power and interesting tasks. These rewards can also

[222] See Brown, M. E./Treviño, L. K./Harrison, D. (2005) and Brown, M. E./Treviño, L. K. (2006), p. 597.

[223] See Bandura, A. (1977); Bandura, A. (1986) and Brown, M. E./Treviño, L. K. (2006), p. 597. "if models do not abide by what they preach, why should others do so?" Bandura, A. (1986), p. 344.

be withdrawn as a sanction. Displacement, degradation and dismissals are also available as sanctions. These standards and sanctions are almost exclusively based on the assessments of the supervisors of behavior and performance within the company. This leaves space for subjectivity and power and underlines the importance of the superior to ethically influence employees. A collaborative team approach can be encouraged through complementary assessments from colleagues and a cooperative management style through additional assessments from employees.

In order to ensure a stable relationship between the incentives and the behavior of employees, it is important that the employees can safely assume that they will be rewarded for their positive behavior.[224] The same applies to the sanctions. The incentive to behave in accordance with the ethical principles must include a higher benefit for the employee. The ethical behavior and the effect of the employee in the company must therefore be isolatable and controllable. For example, an employee cannot influence the sales of a product if the quality of the production is bad.

The reward system must be transparent, consistent and fair. If an employee is rewarded for the performance of another employee, it sends a signal that it is not worthwhile to get involved. The same applies to rewarding or disregarding mistakes or disproportionate remuneration. If one employee does more for the company than another, he will also expect more reward. And if one wants to promote ethical behavior, this must also be rewarded.

What forms of justice are there? In a company, we differentiate between 1. Justice of requirements, 2. Justice of performance, 3. Justice of the market, 4. Justice of qualification, 5. Justice of success, 6. Justice of distribution, 7. Justice of needs and 8. Social justice.

1. **Justice of requirements**

This refers to the requirements that are associated with a position in the company and are mentioned in the job description. E.g. travel, education, professional experience, etc.

2. **Justice of performance**

The basis for remuneration is productivity in the company. What added value does the employee provide? Here the result decisive, not the effort. If the results of individual employees cannot be measured,as in large corporations, the effort and willingness to commit (commitment) are often chosen as a reward criteria. It can be advantageous for the employee to stay longer in the office, even if he does not do any productive work.

3. **Justice of the market**

This relates to a demand for a special qualification from the market. For instance, there is low-demand for language-studies, and a high demand for managers.

[224] See fort he modells of motivation Richter, Manfred (1994), pp. 171.

4. **Justice of qualification**

Here, the employee's performance potential is rewarded. This means that even if the employee currently holds a position in which the job description does not require this potential, he receives a higher pay than someone else without this qualification. The potential is thus available to the company even if it is not being used.

5. **Justice of success**

Since the employee works in the company, his remuneration depends indirectly on the success of the company. Even if he generates high revenues for the company, the company may not be able toreward him because of a a poor economic situation. Often, the companies pour out special bonuses after an economic slump, once the economic situation allows it.

6. **Justice of distribution**

Distribution is a relative measure and refers here to income and other rewards. There is a distribution within the company and a distribution of income in the economy. Both distributions are perceived as being justified only if they are transparent and their criteria are recognized.

7. **Justice of needs**

Karl Marx proposed the quality of necessity ("each according to his needs"). This is about the urgency with which an individual needs an income. For example, a single-parent unemployed mother is in a state of emergency. In this respect, it would be more appropriate to give more to her than to a high-income woman without family obligations.

8. **Social justice**

The goal here is that all individuals in society have the same income chances. For example, Workers are to waive wage increases in order to employ others.

The first three forms of justice essentially determine the wage level in the company. Internal distributive justice has not seemed to exist in recent years. The difference between the manager's salary and the pay of a normal employee rose steadily, without the managers having done better than before and the employees were worse off. In 1997, a member of the Management Board of Deutsche Bank AG earned 50 times the average gross earnings of a worker in Germany, 80 in 1998, 200 in 1999 and 300 in 2000.[225] The US is modeled on this development. There, the average salary of a Chief Executive Officer (CEO) of the 500 largest companies rose by 700% between 1980 and 2001, while the average salary of an industrial worker increased by 15%.[226]

As with Homann's approach, the corporate institutions must be designed in such a way that they promote ethical behavior and sanction unethical behavior. There are also unethical incentives. Thus, in the suit against the automobile-service company

[225] See Härtel, Hans-Hagen (2004), p. 348.

[226] See Eckardstein, Dudo von/Konlechner, Stefan (2008), p. 10.

Sears, Roebuck & Company, the extreme incentives to increase sales led to an increase in the number of cases of customer fraud. There were stipulations of minimum hours for mechanics and minimum sales volumes for certain car parts as well as high premiums for high sales, which put the employees disproportionately under pressure. Successful employees had no scruples, and would sell the customer superfluous service and spare parts. There were therefore incentives to lie and deceive, thus endorsing unethical behavior.[227]

Incentives and penalties only apply if they are carried out within the scope of monitoring the performance and behavior of the employees. The employee must be able to understand the reward. This is referred to as a target-actual control.[228] Ultimately, every measure of leadership, forecasts, systems, models, etc., is also required for success monitoring, because errors must be identified for improvements to be made.

The goals set for the employee by his or her supervisor are matched with his or her performance and behavior. Control is part of the company's information system, without which control of the company is not possible. The superior can and must intervene if deviations from the target are recorded. If he does not intervene, it means that the company's objectives are not met and that regulatory violations are not sanctioned. There is then chaos, and the company targets are not reached.

To adhere to rules or to obey what the supervisor orders is equivalent with a loss of freedom for the individual employee. This also leads to benefit losses. However, it is only so order or better productive value can be realized from the organization enterprise (emergence). This is a prisoner's dilemma and the incentive to free ride is strong. The benefit is maximal for the individual when the others subordinate themselves in order to generate the surplus value and, he does not become subordinate. The ones who do not subordinate themselves still enjoy in the surplus value.

7.3.6.3 The Management Approach of Qualitative Leadership

Beginning with Enron, Subprime etc. we have examined the causes of the company crises and asked what went wrong. We have been able to come to several conclusions, but in particular we see that an exaggerated belief in figures and the neglect of incalculable soft facts can be very dangerous. What is more, we have found out that exactly the soft facts are decisive for the development of productive human forces and thus for the long-term success of companies and national economies. How can the soft facts be influenced for the good of the company, the economy and the employees? In the following we will now attempt to bring our newly won realizations together into a new management approach that provides for the optimal development of productive forces in a company.

The management approach for qualitative leadership does not offer anything new or undiscovered. It is meant to use the realizations and experiences gained to optimally develop the productive forces of a company through the best application of

[227] See Paine, Lynn Sharp (1994), pp. 107.

[228] See Fallgatter, Michael J. (2004), pp. 670.

fewer management instruments. We might consider the focus and the combination to be new, although the most important thing here is to recall moral values, which were once obvious but apparently forgotten, in particular moral values.

The management approach of qualitative leadership is based on aspects from other approaches. For example, the process management concept focuses on organizing how processes are executed. Structuring the process is already seen as a multidisciplinary optimization task for company management. A process-oriented incentive and control system is meant to harmonize the interests of the company and its employees.[229] Lean management approaches and quality management approaches also demand that company management and organization be geared towards the internal value creation change, and the inclusion of employees in constant process improvement.[230] External benchmarking allows us to set goals for internal value creation to achieve. Hierarchical levels are dismantled in favor of teamwork and both internal and external communication is improved.

The re-engineering approaches emphasize that the company organization be continually evaluated and adapted to external changes. The perspective of so-called change management includes company strategy, organization, culture and technology, as well as the interdependent effects from interfering in the company processes.[231] This is incorporated into the qualitative management described in the following. It also contains individual aspects of various, well-known approaches such as the human relation approach, which derives improved performance from a positive social work environment, especially in the relationship to one's superiors and other employees. There are a couple of other approaches using motivational theories (organizational behavior) that stress supporting human resources as mental and physical labor potential. The socio-technical approach from Eric Trist sees company organization as an open, dynamic system with the goal of producing goods. This goal serves as the control quantity for technical and social subsystems. The function of supervisors is to monitor success and give constructive feedback (suggestions for self-monitoring).[232] The management approach for qualitative management places different emphasis and new accents in many areas. Our central question is, "How can we satisfy the human need for moral values in order to increase productivity in a company?"

In a study conducted by the international consulting firm Proudfood Consulting, they estimate that 33.5 days of wasted working time was lost per employee in the USA in 2005. In Germany it was estimated to be 32.5 days. The reason given by the consultants for the time lost was unclear organization or task delegation that led to double work, whereby a lack of understanding of the organization and in particular a lack of information about the lower company units on the part of top managers was a significant contributor. There are often too many managers attempting to be active in the company even though they are superfluous, and they end up being a

[229] See Vahs, Dietmar (2001), p. 222.

[230] See Lawler, Edward E. (1994), pp. 69–76.

[231] See Vahs, Dietmar (2001), pp. 204 and pp. 237.

[232] See Vahs, Dietmar (2001), p. 36.

hindrance to their employees and colleagues. One of the greatest resource wastes are meetings in which everyone informs everyone else and everything is discussed.[233]

Applying employees and machines according to their respective strengths and motivating them to work towards company goals on their own initiative can increase the output productivity of companies. This is the only goal of the qualitative management approach.

What does a company consist of and what comprises its success? If we want to know why one company is successful while another is not, we must examine the differing parts of the companies in more detail. We might also ask which components not easily obtainable by every company lead to success? What is not so easily replaced?

All companies have access to capital, machines, property and all other intermediate inputs traded openly via markets. The important difference between companies begins with the internal organization, or the delegation of functions, internal rules (company constitution or institutions) and especially in the people, the employees, which is expressed in the company culture or working atmosphere. The added values that advance a company in a lasting way, allowing it to grow productively, are always created by people – whether it is from intelligent individual researchers with an enormous individual capital, or from the group that uses its social capital to generate added value (e.g. in research) in the interactive network through cooperation. The manager or management team can be just as resourceful in this environment as the researchers. The success of the company depends on them in the end. Poor developments in a branch are not the cause of company crises. Crises are caused by poor managers, who have missed the trends and the necessary adaptations. With an ingenious management, the company can escape more easily from a branch crisis relative to its competition. Good management shows itself in a crisis. The main static components of a company and thus the criteria for company success are apart from real capital the company organization, the constitution, individual as well as social capital. These components are static however, and must be given life. In the end what determines the success of a company on the market are the dynamic processes within the company. These are significantly influenced by the static factors, but must be at least generally controlled in order to function optimally and achieve the desired results. This is where management comes in.

With what demands does a company today find itself confronted? What is the modern economic framework in which the company must prove itself? What production technology requires which organizational structures and which processes? Rapid technological progress allows more and more simple tasks to be performed by machines. The computer age has increased this trend in the last four decades. For people this not only means relief from the simple, primitive activities, but also increasing competition with machines in the production process. Machines (computers are machines as well) replace humans in more tasks in the production process, and yet they make it possible for humans to create more added value when

[233] See Handelsblatt from 21./22./23.07.06.

working with the machines. This added value makes higher wages possible, and thus an increasing standard of living with continually more products (or free time). At the same time, the labor distribution between humans and machines is changing. More is demanded of people as more simple tasks are done by machines. This trend is clear in the greatly increased lengths of time for study and in the complexity and variety of educational programs. There are other facets here as well. More personal responsibility and initiative are demanded of people in the production process, while they must also monitor and control increasingly complex machines with more production output in the production process. Decisions must more often be made locally. Strict hierarchies with orders and obedience are too inflexible and slow. Monitoring employees continually becomes more difficult, more expensive and ends up being counterproductive. The productive forces from employees applying themselves for the company must come from the employees themselves. They must voluntarily and gladly make the interests of the company their own, thus motivation must come from inside.

As we have already mentioned, there must be a lot of space for individual decision-making and creativity in order for productive forces to develop optimally in an industrial market economy. Only through the largest possible degree of freedom and individual responsibility for one's actions can the positive effects of competition and market be fully enjoyed. Democracy is the only form of government to offer this. The economic system must assure that individual freedom develops productively and does not turn against the system as a whole. The freedom of the individual must have limits. They end where they prevent other market participants from realizing their productive freedom. This connection can be applied to the business level as well, for the company constitution, where the goal is get the most out of the productive forces of the employees. The most obvious would therefore be to organize a company like a national economy, with local decision-making freedom and responsibility from employees. Many management methods are based on this idea, such as the profit center approach. Outsourcing also tries to use the market and competition to improve and reduce the costs of the outputs offered by delegating company functions. The market system cannot be applied to a company system one-to-one because the company as a special organizational form must fulfill a function that the market cannot afford. The company must make a capable whole from the value gained by organizing the systematic assignment of functions. This includes the optimal structure of interactive networks, or the optimal task delegation according to the strengths of each employee.

The local decision-making of the market economy can be applied to a company to a certain degree. Except for assembly line production, most decisions are made locally by the active employees and managers. Seen in this light, a company works optimally as an organization when all lower units make decisions in the interest of the company as a whole. The agency expenses from control and its implementation costs would be eliminated. This is why not only an identification of the employees with the company and its goals has particular importance, but moral values such as loyalty and integrity are important as well. The employees must place the good of the company over their own to a certain extent. Let us take the example of calling in sick. The employee must care for his health in his own interest, and in the interest of the company, yet he must not use calling in sick to have more free time and thus damage the company. Since the employer cannot control the employees 100%, or control is too costly, the employer depends on moral behavior from his employees.

When the individual is the center of the economic process however, a suitable management approach must place human nature at the center in order to best nurture their productive forces. Soft facts must be taken into consideration. Psychology and sociology become important sources for advice, and moral values take on central importance. As we have already addressed, most people need more than just material values to be happy. On the contrary, many people are searching for a meaning in life and have a strong sense of justice, wanting good to triumph over evil. Otherwise the bible and the film Starwars would not be so broadly popular. Moral values, in particular leading and motivating with moral values, constitutes the core of the qualitative management approach described in the following.

Let's look at a current study at the University of Hamburg to illustrate the point. The research group asked almost 650 employees at different companies what is most important to them at work. The results may surprise you. Most employers answered that a respectful employee is more important than a secure position, good remuneration or great career chances. If supervisors do not treat their employees with respect the employees will not be active and engaged. They become less creative. If they are treated disrespectfully they have a hard time respecting their bosses or following instructions. Such a situation can go so far that they stop thinking independently at all and resign internally, only performing the minimum required.[234]

How are processes executed within a company? What is important when trying to make the processes efficient and setting productive human forces in the company free? In the organization of a company, the processes are first structured by assigning functions in the production process to employees and departments. Qualitative management begins at this stage through a manger who attempts to delegate tasks to people according to their potential, so that the forces available in the company can be used as advantageously as possible. More exactly, this means that the processes comprising a company, the goal and added value for the company must be clarified first. Then the management can ask which employee would best be placed which position. Management must put local teams together as cooperative networks. They must decide which employee is best for which team and for which tasks depending on their education, talents and experience. Which employees are best for the cooperative networks and with what social and individual capital? For example, the basic capabilities for a team intending to develop a car might be controlling, engineering and marketing. Interpersonal and emotional intelligence must be considered as well. The organizational structure will then be adapted to the interactive networks and processes.

The final deciding factors are motivation, knowledge and minimization of friction; in other words interface optimization. The employees at lower levels not only have direct access to information relevant for decision-making through their contact

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[234] See Handelsblatt dated February 15th 2007, p. 10.

to production, their customers and the market, they must also implement most company actions. They are the operative side of business. Managers are dependent on the information they receive from the lower levels, as well as on implementation of their instructions. As we have shown above, technical progress has only increased the importance of the lower levels, as they become more of the local company management. On the one hand, the transfer of simple tasks to machines increased individual responsibility at the lower levels. On the other hand, decisions were transferred to the lower levels because they had to be made quickly and demanded flexibility.

Globalization has increased this trend. Globalization in this sense means that the markets are becoming global. This has been made possible by technological progress. Modern mediums of communication and transportation allow companies to produce anywhere in the world and to deliver anywhere in the world. One result is increased transparency, as a world market is being created out of many national markets, for all products, primary products and even the production factor of labor. However the production and sales process, in fact the entire business process is getting more complex with so many production and sales subsidiaries abroad. The increasing complexity makes employee supervision, information and decision processes, and company management as a whole, more difficult for managers. Management is a process of trial and error to an extent, since it is impossible to grasp all factors of influence. Management must be able to judge trends and make decisions based on their judgments. Errors are unavoidable in such an uncertain situation, making the timely recognition of abortive developments all the more important if there is to be a chance at redirection. Management must also react quickly to changes in the many influential factors. In such an environment, the timely control of successes is the most important part of the company process. With a consequent, timely control of success there should no longer be company crises, no change management and no market phase problems.

With the background described above, the requirements that a modern management concept must fulfill are obvious. Management must create a company that exists locally amongst the employees. The system to be created must be innovative and capable of learning, so it can react quickly to changes in market and framework conditions. The employees must collect information locally, evaluate it and then make decisions in the interest of the company. This means that the employees can only be controlled after they have made the decision. The classical management functions must be transferred more and more to the employees at lower levels. The central question is then, how can we assure that the employees live up to these requirements? They must be led and motivated by moral values. Qualitative management means encouraging and demanding the good in people, while negatively sanctioning the bad. Management in this sense includes motivating employees through a personal role model and personal convictions. This includes demonstrating moral and ethical principles beyond just adding qualitative goals to the existing quantitative goals. Motivation means creating enthusiasm for the goals of the company within individuals, groups, and networks. The better one is able to convince employees of the sense and moral value in a goal, the greater their motivation will be. Who does not want to give their lives a purpose and do something good? In this context even production of the simplest object has a benefit for other people and is therefore good and important. The role model function also applies to conflict resolution within a company. Conflicts are often not resolved within a company, but are repressed, which causes motivation and the desire to work to suffer, and aggression to build. New conflicts are then guaranteed. All of this reduces productivity. It is possible to reconcile differences without losing face. Managers who never apologize and never explain their instructions will find it impossible to engage and motivate their employees. These managers do not understand that they are part of a group, the group being the entire company, branch or department.

Appealing to the good in people is often insufficient. Unacceptable behavior must be sanctioned as well, because it is to the disadvantage of everyone and cannot be allowed to pay off. People generally find it easier to behave badly than well. Being of use to others often means giving something up, and it is materially advantageous to augment one's advantage at the cost of others. For rules to be effective however, there must be general acceptance of them in the community. If one has the impression that breaking the rules is no exception there will be neither acceptance nor a willingness to submit to them. The maximum social benefit for everyone is created by everyone following the rules, yet it is especially worthwhile for an individual to break a rule if all of the others follow it. If everyone behaves this way however, we have anarchy with the worst results for everyone where no one follows rules. Qualitative management includes signals to the outside that show it is not worth it to break the rules. The less likely it is that misbehavior will be discovered, the higher the punishments must be in order have the same deterring effect.

Compensation oriented towards productivity and based on the opportunity and risk profile (risk corresponding compensation) is decisive for optimal local employee decisions, the goal being to harmonize interests between principals and agents.[235] This applies for all significant decision makers, not just top managers. Often employees that are not a part of management make decisions affecting the company results over the long term, but they do not participate in the opportunities and risks involved in the decisions. They receive the same salary for success but have to answer for losses incurred. This sanctions negative developments, but does not reward positive developments, encouraging risk-averse behavior. The decision-making situation is distorted by incentives inappropriate to the opportunities and risks. Positions with a strong inherent opportunity and risk characteristic must offer particular encouragement for personal engagement in information collection and processing by involving employees in success or failure. How is a supervisor to evaluate decisions made by an employee if he does not have the necessary information to judge the situation in which decisions were made? Without the right incentives a lot of money is lost, especially in large corporations. Only if the employees see their interests as being the same as those of company, can they make the optimal decisions based on the necessary information.

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[235] See Conrad, Christian A. (2015), p. 50–55.

The demands on employees increase within a company process that is continually becoming more complex, as do the demands on their know-how, or the human capital. Individual capital can be acquired through additional training, but what about social capital? As we have shown, social capital is a decisive factor for the development of productive forces in a company. Added value should be achieved through cooperation, teamwork and by bringing all information and knowledge together as a whole, making the added value the sum of the individuals. The six central characteristics of employees relevant to added value creation described above were: (1) Reliability, (2) Loyalty, (3) Ability to work in a team, (4) Willingness to perform, (5) Integrity and (6) System acceptance. These characteristics are what make or break a fast and complex system for local added value creation. Qualitative management in this context includes guidelines for the desired behavior through information, upbringing or socialization and the perception of a role model function. A role model function between people means treating the employees the way you would want to be treated. Support and encourage them. Everyone has good and bad sides and can decide between cooperative or uncooperative actions. If you speak to the good in your employees, as people, you will generally receive good from them. To positively influence employees the supervisors must first have the trust and acceptance of his employees. In order to receive and keep both, they must be people of integrity and act morally. This is also a prerequisite for the internal socialization process of a company. A manager can only demand of his employees what he himself gives, if not a little less. If a manager wants his employees to be loyal, open, fair, hard-working and cooperative, he must be all these things as well. A manager is a role model above all else (**first function of qualitative leadership**).

As we have shown, the attitudes of the employees are of crucial importance for productive social activity. A manager must use praise and censure to ensure that the attitudes of employees conform to the interests of the company, and to provide a positive, moral working environment (**second function of qualitative leadership**). The employees must be educated or socialized in the classical sense, although we choose to use the term "general company interest" to avoid the idea that a dictatorial company guardian be created. The manager has the job of being more like a modern teacher, who helps the children to reach independent and self-responsible behavior. Despite the decentralization of employee's individual responsibility, it is incumbent upon management to take responsibility for the actions of their employees and to discourage poor performance as well as to reward exceptional performance. The manager is also responsible for assuring productive teamwork in the groups through their intervention. Teamwork without leadership and instructions runs the risk of letting human weaknesses get the upper hand. Team discussions can quickly become independent and lose track of the actual goal when showing off or other group dynamics become too strong. Not all projects and plans have to be discussed in meetings. Moreover these meetings are often abused as a way to foist individual responsibility onto the group. One of the greatest resource wastes are meetings in which everyone informs everyone else and everything is discussed.

The manager has to put the responsibility clearly on the employees and must prosecute nonperformance and reward outperformance. He must leave the employees the room they need to develop themselves personally according to the differences in each person. His task is to recognize and use the differences between employees for the good of the company. He should assign them to the interactive networks so that their strengths can have an optimal effect and their weaknesses can be compensated. This is how the productive forces of the employees can be fully developed, which also leads to self-satisfaction.

A faster and more complex company process formed by independently active employees demands a special working atmosphere of openness and trust. Since the manager cannot control the employees in a local, fast and flexible decision-making process, or at best can only control them partially, he is dependent on their cooperation. The employees must pass on information about markets and production to the manager, but they must also be able to tell him about poor decisions they have made so he can step in to help (which did not happen at Enron). The manager collects and filters the information received by the employees and passes it on via a lean hierarchy to the top management. The information is aggregated through the hierarchy and forwarded upwards where the strategic questions that affect the entire company are decided. At the top management level only broad information is received and directly evaluated, such as national economic or legal framework data. With qualitative management, middle levels of the hierarchy are only necessary to coordinate company processes and to aggregate information. The manager is thus an interface for information (**third function of qualitative leadership**). All managers in a company are committed to the principles of qualitative leadership. This way a fast, innovative and highly motivated organization is created that represents a unit for reaching common company goals.

In order to be able to create added value through cooperation in interactive networks, the employees must trust each other. Only then will they help one another to create common added value. Seen in this light it is much more important that the managers provide for the right characteristics and attitudes of the employees rather than controlling their individual decisions. Managers must impart positive feelings. The motivation of doing something positive for the company comes partially from the employees themselves. They feel a need to do so, and when they have been able to do something good for the company they feel they have been a part of something valuable. These are intrinsic incentives that have slowly been forgotten in the last few decades. Doing something only for money neither provides a good feeling nor does it make one feel loyal. Mercenary soldiers have always been less reliable than a country's own sons who go off to war to defend the home, country and family. The fighters of the Ottoman Empire reached Vienna not because they were paid more than the Europeans but because they were fighting for Islam as a good cause. In the end the most important part of qualitative leadership is that the managers form the employees to the employee's own advantage; motivate and instruct them so that they reach their best performance for the company gladly without management controls, be it alone or in a group. This makes it possible to have fewer managers, higher efficiency, flexibility and speed and proximity to the market. The employees will also be more satisfied because they feel they are creating more than just monetary value, they are also doing something moral, good and purposeful. In this positive moral working environment friction between people will be the exception, which also increases efficiency. The productive performance competition amongst employees is not hindered. It is constructed positively because it is no longer about harming colleagues to secure a better position, as was the case at Enron. In a negative environment there would be no cooperation, only destructive conflict, preventing potential added values in the company from being realized as one employee works against the performance of another and harms the company in the end. In a generally fair and positive working environment employees endeavor to reach their best performance in common effort through constructive teamwork. Cooperation and fairness then usually means placing the company goals over one's own advantage and profit maximization. Cooperation and effort for a common goal is emphasized.

The managers can use their own judgment and the questions of the economic culture approach (see above) to grasp employee attitudes. Managers should also let themselves be evaluated anonymously. This is the only way to get feedback on their management. It is not necessary to make the results of such an evaluation public. It may even be better to keep the results private because it might otherwise stress the relationship between manager and employee. The evaluations will probably not be very objective since many employees lack the prerequisites to evaluate their managers from a balanced perspective. Emotions often come into play, and an evaluation might be uncomfortable for the manager even though he must never take things too personally. It is imperative that the manager interpret the results correctly. A qualitative leadership cannot be implemented without feedback, nor can the potential for improvement on the part of the manger or motivation on the part of the employees be realized. In such a situation productivity is impossible.

As we have seen, technical progress forms the economy and thus the conditions of social existence. There is therefore not just one optimal social order that fits to each economic or technical level of development, since a fitting social and economic culture can maximize economic productivity for the good of the community. Whether this optimal social culture matches the respective nation, can be achieved or is even desired, is another question entirely. Our goal is not simply the maximum economic production with the relative material benefit, rather the maximum satisfaction of human needs, or better yet the happiness of society's members. The economy in this case is only a means to an end, serving the people. We can thus summarize the results of our considerations thus: Morality is essential where human beings interact in order to pursue the same goal in the economy.

Management personnel have a central role to play in corporate ethics. They not only determine the internal handling of employees by shaping the corporate culture and decision-making structure, but also represent the company in external relations. They are ultimately responsible for the company and its internal and external decisions.

7.4 Summary

Management must behave as an example for the employee according to ethical criteria and must represent them externally. Here, justice is a key to the employee's acceptance of leadership. The aim of the management approach of the qualitative leadership is the leadership to shape, motivate and instruct the employees to their own advantage to feel ethically responsible for the interests of the company and to feel this as a positive pursuit.

Comprehension Questions

1. What are the character traits of an optimal leader? Give reasons for your opinion.
2. Name and explain the forms of justice presented.
3. In your own words, sketch the management approach of qualitative leadership.

7.4.1 Ethical Staff Selection

7.4.1.1 The Selection Process

Corporate culture can be influenced most by the selection of staff. Personnel selection means the internal or external occupation of positions in the company (definition). This has three important meanings for corporate culture. Firstly, in the case of external staff assignments, the decision is made as to which persons are allowed into the company, and they will in turn influence that corporate culture. Secondly, management is assigned power, that is, influence on enterprise culture. Thirdly the selection of supervisors as promotions is a main incentive for the performance of the employees.

The selection of staff is also one of the most complex and significant company decisions. Complex and thus difficult, because the company does not know the character, abilities and intentions of the applicant due to asymmetrical information distribution, particularly in the case of external positions. It is important to note that these decisions can only be made at short notice with high costs, which have very far-reaching consequences for the company. The higher the position, the higher the consequences and costs for the company, which can include bankruptcy.

The selection of staff is the decisive instrument for the long-term organization of corporate culture. Many personal characteristics are so deeply anchored that they can no longer be influenced ethically. It is therefore very important to select the most ethically appropriate employees and, in particular, executives.

The ethical requirements must be included in the job descriptions. The company guidelines and codes of conduct must also be included. The higher up in the hierarchy, the higher the demands on that personality in order to meet employee expectations and thus ensure personal authority. In the next step, the job description must specify the exact requirements profile for the applicant. Then the vacancy notice and finally the selection of the candidates are carried out by comparing the job profile with the applicant profile. The following are instruments to scan the profile of the applicant: curriculum vitae, personal questionnaire, testimonials, references, photographs, manuscripts, assessment center etc.[236]

Naturally, the selection procedure should also meet ethical requirements. Thus, no candidate may be discriminated against based on sex, color, religious affiliation, political orientation or the like. These criteria therefore also fall under the legal protection of privacy and may not be requested by the company.[237] Women may not be asked about pregnancy. A frequently discussed women's quota, which is to say the percentage of women employed, will lead to discrimination if unequal numbers of women and men applying are equally suitable or qualified. Nonetheless, one could prevent discrimination by applying a gender proportion in the selection committees. It is crucial that a pre-employment application process is externally transparent.

The selection criteria must be clear to the candidates. Otherwise they cannot decide whether they have any interest and a chance at geting the job (self-selection). If an erroneous impression is made by the job description, this results in unnecessary transaction costs for the applicant and the company. In order for both parties to be able to learn from the application process, a success check is to be carried out. It begins with the feedback talks with the applicants not selected and ends with the evaluation of the return of the first internal company assessments. The vacancy notice documents the criteria that must be checked within the selection procedure and also documented with the result.

The selection process itself has to be ethical. In particular, the applicant's human dignity must be respected. The applicant may not be exposed or compromised. This is especially important when simulating extreme situations so as not to create too much stress and pressure. Open honesty is an important prerequisite for the optimal selection of applicants on both sides. The applicant is also a long-term decision with far-reaching consequences. Other settings can not be used. Perhaps a move is also associated with the acceptance of the job.

Job posting is of particular importance since it is the first contact between the company and the potential applicants. For the success of a job call, it is crucial that the job description optimally sketches the requirements profile so that the reader has a basis for deciding whether his profile fits the job and whether he is interested in the company and the job. If mistakes are made here, the job advertisement responds to the wrong applicants or conveys a false picture of the company.

7.4.1.2 Selection of Ethical Employees in Practice

Group task: Discuss the following example for personnel selection. What type of employees are being sought here?

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[236] See Richter, Manfred (1994), p. 411.

[237] See Göbel, Elisabeth (2010), p. 230.

An example of personnel selection, according to William Cohan in the film "Goldman Sachs – eine Bank regiert die Welt"[238] ("Goldman Sachs – a bank governs the world") was operated by Goldman Sachs. The trainees, who are still in the probationary period, will be invited to a meeting on Friday for 4 pm. Hours pass and no one comes. The trainees think they've been forgotten or treated badly. Some go. At 10 pm the head of the department will come and sign an unimportant paper from the trainees who are still present. All the others are rejected the next day.

Solution: You are looking for dedicated employees who do not ask questions and do not show their own initiative. Independence and criticism are not welcome here.

According to Stanford professor Jeffrey Pfeffer, successful managers are selfish, mendacious and reckless. Peffer is thus opposed to the dominant leadership theory that "good managers should be modest, sincere and authentic. This fallacy spreads especially in the leadership industry with its seminars, books, trainers, coaches and, of course, the business schools and personnel departments."[239] Pfeffer does not question that companies would benefit from an ethical leadership, but he sees this as unrealistic and encourages young managers to behave unethically to make careers.

"Of course these are all wonderful qualities and there is also no doubt that companies and their employees would be better off if their leaders behaved morally. But they do not. They usually do the opposite of it. One reason are well-known psychological mechanisms. Whoever wants to be successful must not be modest, but must make as much self-promotion as possible. And lies are not only ubiquitous, but also very effective. According to a study, 74 per cent of companies say it is right to lie about their true chances of advancement, because they would be less involved."[240] To be successful, according to Pfeffer, managers must be nasty. Successful managers are loud and lie to themselves and others.

"Managers often present themselves completely differently than they really are. They create their own reality and believe in it. This self-deception also has a tremendously positive effect: anyone who can deceive himself can also deceive others. Or the concept of moral licensing: when people have once behaved ethically or morally, they have the feeling that they are allowed a meanness. All of this is empirically proven."[241]

According to Pfeffer, the good qualities, the virtues such as modesty, sincerity, and trust counteract career advancement. Only one who is striking is promoted. For this reason, narcissists, according to Pfeffer, are often leaders, because their superior self-confidence is mistakenly perceived by other people as competence. Lies are sanctioned in the company and are considered a part of leadership. Anyone who lies – especially about his own achievements – is therefore promoted. This also

[238] See https://www.youtube.com/watch?v=pbCWfvn0mLU

[239] http://www.spiegel.de/karriere/manager-wer-erfolgreich-sein-will-muss-fies-sein-a-1115117.html, translation by the author.

[240] http://www.spiegel.de/karriere/manager-wer-erfolgreich-sein-will-muss-fies-sein-a-1115117.html, translation by the author.

[241] http://www.spiegel.de/karriere/manager-wer-erfolgreich-sein-will-muss-fies-sein-a-1115117.html, translation by the author.

includes the breaking of promises. Pfeffer considers trust useless for a company because promises are so often broken with impunity.[242] Pfeffer's theses are in his book that was 2015 Finalist for the 2015 Financial Times and McKinsey Business Book of the Year.[243]

Pfeffer's thesis on the unethical behavior of managers is confirmed by a German psychotherapist Leitner.[244] She sees a development: "Psycho-games are working out in these big companies because they often have no values. Above all, more and more ego-types are spreading, who only think of their own career, which the company's well-being is indifferent to." And further: "My experience is that generally the sleeze and the powerful prevail and the decent, motivated have to go. It is an unequal struggle that mostly women almost always lose. Most people only realize that they have been fought when they have already lost the war."[245] Bodo Janssen seems to have been such a leader. After an employee questioning, it turned out that his subordinates hated him, which surprised him very much: "The survey was a shock. Suddenly, I was no longer an all-knowing top manager, but a flop manager. But I have faced the problems. We now have a completely different corporate culture, without power, pressure and control. Satisfaction has risen by more than 80 percent since then, the employees are much less sick, we receive five times as many applications and have more than doubled company's sales."[246]

Derler surveyed 138 executives from the middle (52.9%), lower (33.3%) and top management (13.8%) from the service, automotive, IT and engineering sectors about the criteria in the selection of employees, specifically the selection of non-executives. Reliability, productivity and loyalty are most often mentioned here. Furthermore, the majority of the companies surveyed prefer well-adapted employees. Desired characteristics are also diligence, politeness, team ability, self-awareness, instability, and deviation from company trends. Derler sees this as a contradiction between external representation and practice, as most of the surveyed companies considered themselves innovative and open to new developments.[247]

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[242] See Pfeffer, Jeffrey (2015), Leadership BS Fixing Workplaces and Careers One Truth at a Time, New York: Harper Business.

[243] See https://www.amazon.com/Leadership-BS-Fixing-Workplaces-Careers/dp/0062383167

[244] Madeleine Leitner is a graduate psychologist and has worked for a long time as a psychotherapist in hospitals, as a court-appointed expert and as a personal consultant for big corporations and is currently working as an independent career consultant. *See http://www.spiegel.de/forum/karriere/psychospiele-im-management-konzernen-machen-sich-ego-typen-breit-thread-228194-14.html*,.

[245] *http://www.spiegel.de/forum/karriere/psychospiele-im-management-konzernen-machen-sich-ego-typen-breit-thread-228194-14.html*, translation by the author.

[246] http://www.spiegel.de/forum/karriere/erkenntnisse-eines-chefs-ich-war-ein-flopmanager-thread-449737-1.html, translation by the author.

[247] See https://www.fernuni-hagen.de/universitaet/aktuelles/2015/03/ 2015_03_23_am_studie_der_ideal_mitarbeiter_fernuniversitaet.shtml

The selection process of executives has different criteria than those for employees. Schneider evaluated the job advertisements of various cross-regional German newspapers in order to produce an average managerial profile[248]:

Leadership characteristics, in 46.2% of ads (number of responses):

(11), general leadership style or sensitivity (10), employee-oriented (7), the ability to be motivated (70), success and goal orientation (32), general leadership quality (32), cooperative management style (32), employees can develop (7).

Social characteristics, in 39.2% of the ads (number of mentions): negotiating skills (72), assertiveness (71), co-operation skills (54), team ability (48), communication skills (47) (32), conviction (31), empathy (21) (33), analytical thinking (28), conceptual thinking (23), economic thinking, cost-orientation (22) (11), strategic thinking (11), sales-oriented thinking (11), fun, motivation, pleasure (10).

Task-related characteristics, in 39.1% of the advertisements (number of mentions): organizational gifts (97), commitment (59), self-employment (49), commitment (43), flexibility (17), reliability, diligence, conscientiousness and patience (17), mobility (16), decision-making (14).

Personality-related characteristics, in 19.7% of the ads (number of responses):

managerial personality or vendor personality (92), personal qualities such as integrity (17).

The conclusion of the study is that ethical characteristics play a subordinate role in the selection of managerial staff. Although the managers have creative leeway, they have to subordinate themselves to the corporate objectives. The management features (23.8% of the total sample) dominated the management with a staff-oriented approach with 51% of the nominations.[249] In addition, there is an ethical aspect ("employee-oriented," "sensitivity," and "cooperative leadership style") in many leadership areas, and some terms show overlapping traits ("employee-oriented" and "encouraging and developing employees").

Indirect ethical properties can be deduced from the required properties. Conscientiousness, reliability, and integrity also contain a social (moral) orientation as secondary competencies. Furthermore, social skills such as empathy, co-operation and communication skills are required, which form the basis for discourse ethics. The requirements established under the leadership are indicative of a partnership-oriented leadership style.[250]

In job advertisements the concept of social competence is widespread. It is seen as a criterion for leadership and competitiveness. However, the term is generally not specified in detail.[251] The term acts as a collective term for social or group-specific abilities. This is generally understood to mean that the person is in a position to assume responsibility within the community and to contribute positively to social development. In particular, one has to respect morality and ethics, to work on one-

[248] Schneider, however, relativizes the statement meaning, since the indications also have a PR character. See Schneider, Armin (1993), pp. 82.

[249] See Schneider, Armin (1993), p. 87.

[250] See Göbel, Elisabeth (2010), p. 233.

[251] See Große-Oetringhaus, Wigand F. (1993), p. 273ff and Graf, Andrea (2002).

self in order to develop their own morality and to recognize and acknowledge their own responsibility towards the community or nature. This results in a respectful, fair, sincere, tolerant, compromising and sensitive attitude towards others.[252] In this way, social competence would correspond to interpersonal and intrapersonal as well as emotional intelligence.

The classic way to check applicants for their ethical attitudes and assessments is the personal interview. Surprisingly, the company's guiding principle, as well as the values and norms of the company as guiding principles, are rarely a basis for the selection of candidates, as an older survey shows. They are also not legally binding.[253] However, there are companies, such as BASF AG, which try to select their executives according to fundamental values and guidelines.[254]

As described in Sect. 5.1. Economy and freedom – a historical overview, the current economy seems to lack knowledge about the importance of ethical values for long-term enterprise success. Only one in three top managers[255] says that morality plays an important role in the economy as a whole. Another third see the importance of morality in German leadership as more ambivalent, and the last third of top executives believes that moral questions are of secondary importance in practice. However, 13% believe that the moral value is absolutely inadequate, and 13% is not just the belief that morality does not belong to the economy, but on the contrary, that the economy requires a minimum of amorality. Only one-third of German top managers consider ethically responsible action to be not only desirable, but also largely implement it in day-to-day business. About 13% of the top executives in Germany even believe that the economy and morality are ultimately incompatible.[256] A typical statement from a top manager is: "In the end one is measured by their success, and one does not survive if one upholds morals."[257]

In a survey of 443 executives, 32.9% of respondents said their boss was morally questionable from time to time. Six percent even stated that the actions of their superiors were mainly problematic. Only 61.1% of executives rated the behavior of the superiors as "correct." More than 80% of executives said they had had to act against their personal convictions at least once, and every ninth (11.3%) felt that this was often the case.[258]

According to Buß's survey, about one-third of German executives correspond to the type of morally indifferent manager, who argues that economics and morality are ultimately incompatible, and that in cases of doubt, it is necessary to resort to

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[252] See Faix, Werner G./Laier, Angelika (1996), p. 63 and Thommen, Jean-Paul (1995), p. 17.

[253] See Schneider, Armin (1993), p. 101 und 126.

[254] See Schneider, Armin (1993), p. 102.

[255] Part of the survey were top executives who held the position of Chairman of the Board of Management, Chairman of the Supervisory Board or a member of the Executive Board in the 100 largest companies in Germany (in 2000).

[256] See Buß, Eugen (2009), pp.11.

[257] Buß, Eugen (2009), p. 18..

[258] See Die Akademie für Führungskräfte der Wirtschaft (2012), p. 18.

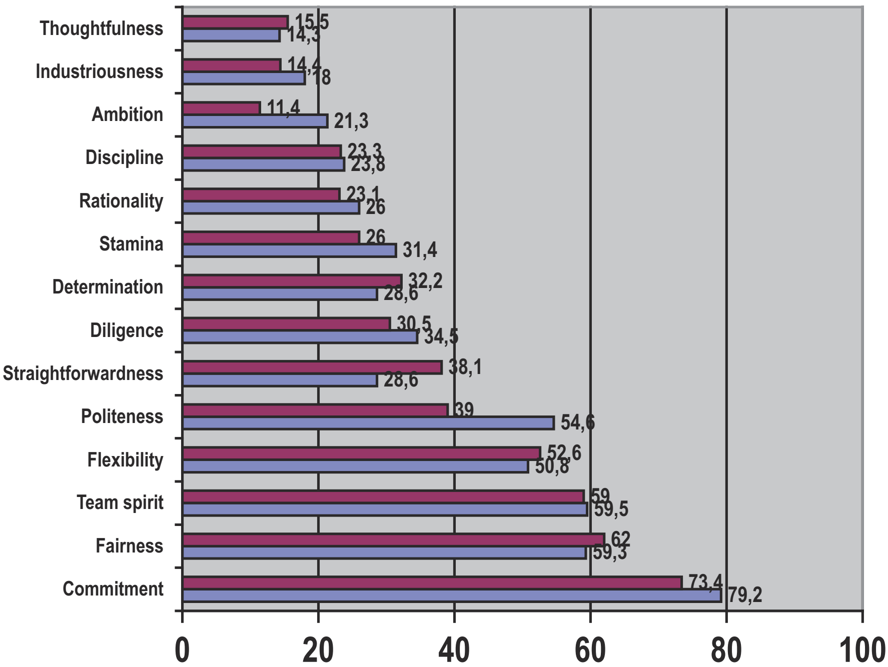

Fig. 7.17 Characteristics and Behaviors of Executives

immoral means.[259] A typical opinion of a morally indifferent manager is: "I seriously doubt whether one can always hit immediately with the great moral hammers. Not everyone can carry around an ethics catalog. False morality disturbs me, that we are a moral institution and that we should make profits by mistake. This kind of hypocrisy is not my world."[260]

However, the managers themselves assess their leadership orientation differently. They see their behavior characterized by fairness, team spirit and commitment, and their general life orientation is oriented towards loyalty, recognition and success (Figs. 7.17 and 7.18).

Answers of the managers in percent to the question "Which of the following factors have the greatest importance for you in your life and determine your behavior in a sustainable way?", Multiple selections possible (n = 443). Source: Die Akademie für Führungskräfte der Wirtschaft (2012), author's translation.

It therefore appears that the social and ethical abilities are sought during the selection process above all for the subordinates, not for the leaders, which is clearly demonstrated by a knowledge deficit in the economy. Another contradiction was already apparent in the early 1990s. The executives demanded obligations from their employees, such as order, discipline, loyalty, thoroughness and reliability, but

[259] See Buß, Eugen (2009), p. 16 f.

[260] Quoted after Buß, Eugen (2009), p. 17.

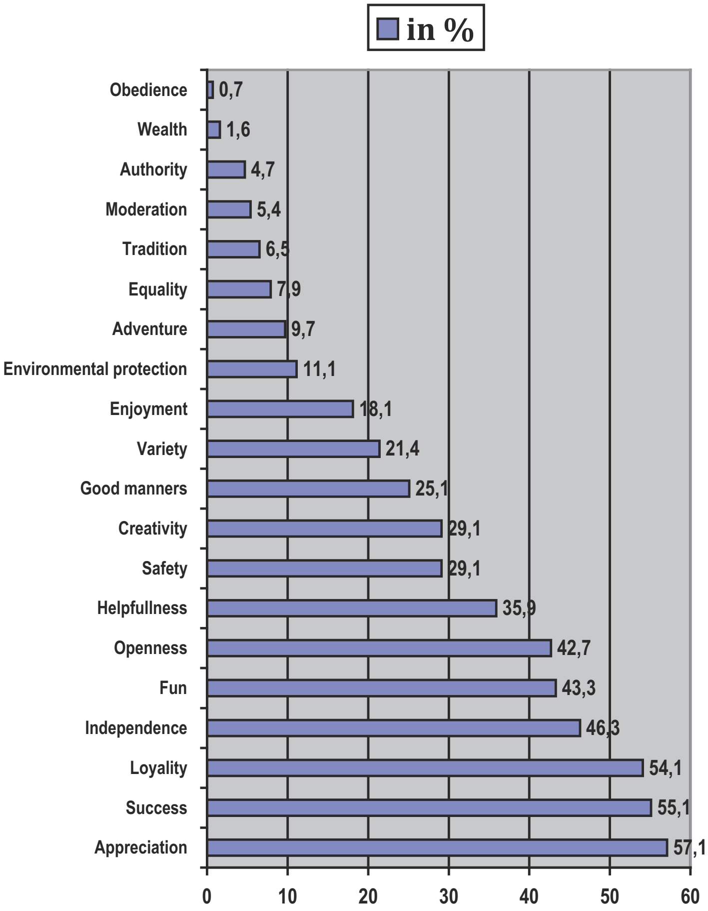

Fig. 7.18 Behavior Factors for Managers

emphasized values of self-determination, self-responsibility, participation and creativity.[261]

This is all the more serious as Windolf, in his investigation of the fraudulent Enron and WorldCom, found that the company selection mechanisms for executives resulted in the selection of persons who are aggressive and, in the extreme, also strive for a high income with criminal energy.[262]

Even among themselves, executives are often characterized as self-centered, self-absorbed, vain, power and status-driven, distant and non-communicative.[263] This would also make it impossible for executives to hold a personal ethical assessment and selection. Would they be able to run a company?

[261] See Dahm, Karl-Wilhelm (1993), pp. 4.

[262] See Windolf, Paul (2003), pp. 195.

[263] See Schieffer, Alexander (1998), p. 296.

7.4.1.3 Reasons for the Ethics Deficit in the Personnel Selection

Due to the above-mentioned complexity of the personnel selection procedures, they are regarded as particularly error-prone. In order to increase acceptance and to ensure ethical transparency, a selection procedure should be explained in its main features.[264] An applicant may prepare for the selection process, for which there is extensive literature. In this sense, it is an illusion if one hopes to get an objective picture through such a procedure. There will always be the subjectivity of the candidate, the artificial test situation and the manipulation or acting of the candidate. The question of social engagement is also known to be often partially fabricated, as the applicants have sought such an activity solely for their CV. Against this background, social activity can no longer be interpreted as a sign of sacrifice and group orientation.

It is to be assumed that the appropriate candidate is often not recognized, so that inappropriate candidates get the job. While enterprise-wide testing procedures such as assessment centers are increasingly being used, their validity and reliability are very controversial. Often, the requirement profile is not detailed enough, or there are subjective judgments of the personnel. The applicant can also feign suitability by acting as well as manipulating the application documents.[265]

Assessment centers make it easy for human ressource managers to assess a large number of applicants according to objective criteria in a relatively short period of time. These tests can be prepared for, and to be successful the candidates have to optimize their answers according to the given criteria. In these mass tests there is no place for the edges of a creative personality. And the internal selection procedures often call for adaptation. Contradiction does not pay off.[266] Moreover it is difficult to adjust the selection criteria properly if assessment centers are used for external and internal staff placements. First, if the employees are chosen by criteria like obedience and absolute loyalty it might be difficult to later find the critical individuals who chose their own unique way as leaders among this selection. Second, assessment centers have negative effects if applied for internal promotions. The question that arises here is, why should one use an assessment center to check people who are already known in the company and have proven their abilities on more than a thousand occasions. An assessment center will never be able to match this. If employees have worked hard to be promoted and fail in the assessment center they are frustrated and are compromised in the company. They might then want to leave the company. This might be acceptable if the assessment centers were an infallible and precise tool to assess people's attitudes and capabilities, but this is not the case. In real life the selection criteria are often not communicated and transparent. They are executed by people so they will not always be repeatable with the same outcome.

[264] See Wittmann, Stephan (1998), p. 423.

[265] See Göbel, Elisabeth (2010), p. 230.

[266] See Handelsblatt dated Otober 20/21/22th 2006, p. 1.

Assessment center results would also be more accepted if they had been proven with all the employees and executives. Finally assessment centers seem to increase the conformity of employees in the company by using the same selection criteria, which must be seen also as a disadvantage as a diversity of characters will increase the benefits of labor division (synergy) and the innovation and problem solving capacity of the company.

The problem of asymmetric information about one's ethical orientation exists particularly in the selection of executives from external candidates. Contrary to this the internal applicants have usually been observed by the company for many years. Not least for this reason, the management positions have traditionally been occupied by internal managers.

Then there are still paradoxes in the internal promotion. As already shown, performance is not always transparent. Often it is important to seem more qualified than one is. Then there are the so-called networks. When a strong leader is promoted, he generally pulls his loyal subordinates upwards with him, but these are often not qualified executives, but employees who never criticize leadership and never disagree – the yes men. They do not have their own personality and therefore they have no leadership skills. As a rule, a strong leader not only prefers unconditional opportunists to the cross-thinkers because they are more comfortable, but he will also be careful not to take any of the equals or even a more qualified leader into their circle of power. Skilled leaders could steal his show and then his position. Better there is only one light that shines in the dark. The Citigroup boss Prince followed his charismatic career father Weill into the chief post. The trained lawyer is said to have had no experience in the operational banking business when he took office.[267] The deputy of Richard Fuld, the head of Lehmann (Joseph Gregory) has said that his greatest strength was that he could not become dangerous to Fuld.[268]

Of course one must be able to afford such a politically motivated and unproductive placement. At best, this can be afforded by a large company in which sufficient other employees compensate for the reduction in value added through the lack of the unskilled executive. The more important the company's position, the higher the cost of such a wrong human resource decision. In general, such missions can only be sustained if the people either do not have to prove themselves or the effects of their wrong decisions are not noticed, for example, in the absence of clear responsibility assignment or in the absence of functional controlling. In general, the larger a company, the more positions are politically occupied.

It is therefore not surprising that the employees of family businesses are more satisfied with 75% than the employees of large conglomerates, where only 65% are satisfied or very satisfied. These are the results of a study in which 389 specialists and managers aged over 40 in 2015 were interviewed by the professor Erika Regnet and the company consultant Boris Gloger. Gloger attributes this result to "tactical games and meeting delusions." There is too little entrepreneurial freedom, which is why much in meetings is to be collectively agreed. According to Gloger, fewer hier-

267 See Handelsblatt dated October 11th 2007.

268 See Der Spiegel No. 11 (2009), pp. 43.

archies and a stronger focus on results lead to higher productivity and satisfaction among the highly motivated specialists and executives. Andreas Schüren, a partner and entrepreneur consultant at Ebner Stolz, sees family businesses as long-term oriented, they think in 10–15 year periods and not in quarters like the big public corporations.[269]

Perhaps, however, the career paths of adaptation are also unattractive with partial immoral preconceptions. If it is only about adaptation and subordination to the company's goals, or rather to the superior, there will be neither time nor strength for other human goals such as friends, family, and social obligations. The top positions and the path to them are unattractive for personalities. A balanced life according to the goal of Aristotle can not be carried out here, which is why usually only the opportunistic careerists follow this path. They are above all concerned with power, personal advantages and, at best, self-assurance, but they are not willing to self-sacrifice for the company.

Another reason for the business hurdles seems to be overwhelming corporate leaders. Jeff Skilling at Enron, Bernie Ebbers at Worldcom, Percy Barnevik at ABB, John Chambers at Cisco, Jean-Marie Messier at Vivendi and Cees van der Hoeven at Ahold and last but not least Dennis Kozlowski from Tyco led the entrusted enterprise as a lone ruler with their charismatic and exaggeratedly self-assured personalities. Blinded by initial successes, companies and capital providers followed them to their downfall. This is a human group phenomenon, which is often observed with a strong concentration of power. At some point, the rulers themselves believe in their infallibility, become light-hearted, uncritical and only tolerate yes men in their environment. In the case of companies, this is often expressed in a quest for ever-greater power through sprawling acquisitions, which in some cases are no longer controllable and overwhelm the company. Tyco holds the record with up to 200 company acquisitions during the peak periods.[270] Later, Kozlowski was sentenced to 25 years imprisonment for fraud and other offenses, and Tyco's shareholders and creditors were judicially allowed to sue ex-Tyco auditors PricewaterhouseCoopers. The Group had reported revenues of $5 billion too high, which is why the new management, in an out-of-court settlement, agreed to pay $3 billion as indemnity to the plaintiffs.[271]

Many top managers have great weaknesses in their personality as well as in their abilities, which have almost ruined some companies (such as ABB and DaimlerCrysler) and have ruined others (Enron and Worldcom). What is the cause? How are leadership positions given when performance, ability and integrity are not the key criteria? As already mentioned, job placements (especially the external) have the risk of hidden characteristics. People who have good self-representation and do not take truth very seriously are always in the advantage here. An employer, including a supervisory board, can only be accused of making a mistake, but they did not act for a long time if the weaknesses of the appointed managers have come

[269] See Tödtmann, Claudia (2015).

[270] See Probst, Gilbert/Raisch, Sebastian (2004), pp. 38.

[271] See Handelsblatt, 16.05.2007, p. 11.

to light. But another aspect is much more important: a company is first and foremost a functional grouping of many people, an organization. And this is where people are concerned with power, influence, prosperity and the distribution of it. In this environmental sociology, the behavior of people in the group comes into play.

Let us assume that humans descended from the monkey. As has also been observed in groups of monkeys, the pith arrangement, that is, power and recognition, is not directed at the strength of the individual, but at political influence in the group. The relative strength of all group members, whose support can be won by an individual, is decisive. If a group member wants to have more influence than others, they must form alliances. As a rule, the people who are supported are strong, otherwise they could not get along within the alliances, but the qualification and the strength needed for them does not have to be the same as a professional or moral qualification or ability to lead a company. Above all, political qualifications are required to give others the impression that their personal interests (primarily power, influence and salary) are best represented in the company. Finally, if two rival alliances are each not strong enough to push through their desired candidates, they often agree on a compromise candidate. He is then often weak in both technical and political terms, so that he cannot harm the alliances in the key position to be filled.

Conclusion

If many executives do not have the appropriate personality and attitudes to show personal authority, and are not an ethical role model who leads ethically, it creates a productivity and security issue for the enterprise. For the shareholders it is not possible to identify the unsuitable executives from the outside due to the asymmetric information.

Personal interviews and anonymous executive evaluations are required in addition to personality questionnaires in order to make the management structure and culture more transparent to the company's management. Otherwise, independent organizations are created in the company that can pursue objectives different from those of the company. Lower superiors become dictators who harass their employees, who in turn check out internally. The information image is manipulated by the superiors to appear in the best light possible. Company management then makes decisions on the basis of false information, which are either partially implemented or not at all.

From this perspective an ethical aptitude test would be required for managers. Especially when a company is developing badly, this can also be due to the lack of ethical orientation from the managers. Then the positions of these employees would be occupied again if one wants to increase the productivity of the company. How to establish ethical attitudes?

The value orientation of employees and managers can be determined by questionnaires, case studies, group discussions and planning games. For example, an ethical dilemma (see below) or the desirable qualities of managers can be discussed in a group.[272]

[272] See Göbel, Elisabeth (2010), p. 235.

Various test methods have also been developed specifically for assessing the ethical orientation and judgment of executives.[273]

Roleplaying: Behavior as a Criterion for the Ethical Selection of Staff
A balloon has to throw ballast or it will crash into the sea. Who should go?

Four seminar participants sit in an imaginary balloon. The rest of the seminar participants evaluate the behavior of the four and their solutions. Who is faithfully ethical and yet constructive?

Summary
The selection of staff is one of the most difficult and important corporate decisions. Due to the asymmetrical distribution of information, the company does not know the characteristics, abilities and intentions of the applicant, particularly in the case of external positions. Standardized procedures such as the assessment center do not alter this problem. On the contrary, there is also the danger of an incorrect preselection. At present, there is too little emphasis placed on ethical criteria, particularly in the selection of executives, which explains some of the shortcomings of corporate policy in recent years.

Comprehension Questions
1. What are the main problems of personnel selection? Can assessment centers help solve problems? Explain your opinion.
2. According to which criteria are employees and managers predominantly selected?
3. What do you propose to take more consideration of ethical criteria in the selection of staff?

7.4.2 Ethical Personnel Development

Traditional personnel development is part of personnel management, which also includes the external job placement. The aim here is to adapt the qualifications of the employees and executives to the requirements of the company by means of suitable measures. This includes the further development of employees within strategic business planning for future tasks. Personnel development therefore depends on personnel selection. More specifically this means optimizing job assignments by means of transfers and promotions, adapting the qualification of employees to the job profile by means of training, continuing education and training, and, conversely, adapting a job to the qualification of an employee (so-called organization ad personam). Regular performance and potential assessments should reveal the targets and actual deviations of the job requirements. These gaps are then closed by personnel

[273] See Staffelbach, Bruno (1994), p. 248 and http://www.tuev-nord.de/cps/rde/xbcr/tng_de/pdbethi_2089553937k.pdf

development measures. If this is not successful, the positions must be changed internally or externally.[274]

This can be transferred one-by-one to ethical personnel development. The goal of ethical personnel development is to increase the moral competence of the employees. An immediate advantage is the avoidance of scandals and court proceedings and thus gaining a better reputation. Indirect advantages, such as a higher level of employee satisfaction and ultimately higher productivity have already been shown above. Furthermore, as we have seen, the ethical preconditions are the basis for overcoming moral hazards, that is, the pursuit of corporate objectives by the executive without enriching the company at the expense of the principal. Ethics thus ensure motivation and productivity. Regular behavior evaluations as well as attitude and character evaluations should also reveal the target and actual deviations from the job requirements. These gaps are then closed by ethical personnel development measures. If this is not successful, the points must be changed internally or externally. How to measure ethical behavioral dispositions?

7.4.2.1 The Step Model of the Moral Judgment from Kohlberg

In his step model Kohlberg shows the development of human moral judgment in life phases. In his approach, Kohlberg blends different characters and affective actions and concentrates exclusively on the way ethical problems are addressed (ethical problem-solving complexity). This leads to the modes of action which we would call good, moral or immoral. Kohlberg carried out a structural analysis of the responses.

Kohlberg used the so-called Heinz dilemma to test the ethical weighing of the subjects. A man named Heinz has a wife who is dying. There is only one remedy that a pharmacist has developed. But the pharmacist only wants to sell it for ten times the price of the production costs. Heinz tries everything to get the money, but unfortunately unsuccessful. In his despair, Heinz finally breaks into the pharmacy and steals the drug.[275]

A. Preconventional Level
(Corresponds to children up to 9 years of age, some adolescents and criminal adults)

1. Level

Initially, actions are carried out solely on the basis of a determined reward and punishment. There is no self-reflection.

2. Level: Recognition of reciprocity

As in the market, one sees the actions that affect others in terms of what you get for yourself. The exchange principle is dominant. Like is rewarded with like (tit for

[274] See Oechsler, Walter A. (1997), pp. 440 and Berthel, Jürgern/Becker, Fed G. (2013), pp. 413.
[275] See Kohlberg, Lawrence (1971) and Kohlberg, Lawrence (1996).

tat / do ut des). There is no questioning of one's own position, no weighing of the effects of self-action, thus no conscience or sense of justice. People are beneficial because they are oriented towards the user.

B. Conventional Level
(Is the level at which the majority of adolescents and adults are located)

3. Level: Interpersonal concordance or external orientation ("Nice boy/girl")

The moral expectations of others are recognized. Social recognition is considered important. The social norms and values of reference persons, authorities or the society (group) are decisive for this reason, which is why they are oriented to this (third-party determination). If one does not live up to the moral expectations of others, one develops feelings of guilt, but also develops moral expectations for the group.

4. Level: Understanding the system

One recognizes the necessity of law and order and social norms and rules, which is why one is prepared to behave morally without reward or punishment or recognition of a reference person.

C. Postconventional Level
(Is achieved only by a minority of people, and if at all, then only as an adult older than 20 years)

5. Level: the legalistic orientation to the social contract

Moral norms, rules and laws are not accepted as given by the outside, but are questioned and acknowledged only if they are logical or cause societal advantages. This requires a strong analytical ability. One is in a position to form a moral judgment. It is, however, a diffuse moral image. About a quarter of all people reach this level.

6. Level

Behavior is based on universally valid values which are recognized and taken into account as the basis of human action, such as the categorical imperatives and values such as justice, human dignity and equality. The moral action, the respect for others, comes from inner conviction. Man is self-centered ethically and not on the search as in level 5. One is in a position to weigh the consequences for others according to these universal criteria within the framework of discourse ethics and to arrive at the morally right decision. This level is reached by approx. Five percent of people.

Kohlberg's theory was also tested empirically by others. Turner found that Kohlberg's levels of moral judgment are positively correlated with the acceptance of leadership as an example from the point of view of the employees.[276] This also confirms the approach of personal authority.

[276] See Turner, N./Barling, J./Epitropaki, O./Butcher, V./Milner, C. (2002).

The Kohlberg model can also be summarized in three stages of moral judgment[277]:

1. Level: morality according to regulation

There is only an orientation to the laws and norms, more precisely to the sanctions. If there is only a small risk of being punished, or the penalties are light, one behaves unethically. By way of example, the speed limits are exceeded if there are no speed controls.

2. Level: Moral on reciprocity

"Treat others as you want to be treated, for instance by your colleague or your competitor" (Golden rule or part of the categorical imperative as well as "live and let live"). Man achieves the insight that we are dependent on one another in the workplace and that other interests are also to be accepted.

3. Level: Superior morality of responsibility

There is no reciprocity when the ethical behavior serves overarching goals, values that have been understood for themselves (ethos). Behavior is based on principles that are thought to be right and one tries to weigh the consequences of their own actions ethically.

Conclusion and Criticism

Kohlberg shows in his step model the development of the human ethical judgement capability in life phases. Kohlberg's test methods can, for example, determine the moral judgment of the executives. In order for executives to be able to fulfill the complex tasks of employee management and balancing the various stakeholder interests, they must have arrived at the postconventional level.

It is undoubtedly true that people who have a good character and weigh the consequences of their actions can proceed from the child level as described by Kohlberg when the environment encourages ethical behavior.[278] However, there are also adults who are on one of the lower moral development stages. The question is whether this is a development that can be carried out by all people and how they can be influenced externally. Kohlberg has been criticized for only declaring the moral judgments, but not the behavior, and that the ethical behavior does not necessarily follow from the judgment.[279] Nevertheless, judging is the prerequisite for behavior and so is decisive. In the meantime, the relationship has also been demonstrated empirically. Ashkanasy et al. showed that ethical decisions are positively correlated with the ability of moral judgment.[280]

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[277] See Dahm, Karl-Wilhelm (1993), pp. 8.

[278] See Staffelbach, Bruno (1994), pp. 248; Achouri, Cyrus (2015), pp. 223; Kohlberg, Lawrence (1971) and Kohlberg, Lawrence (1996).

[279] See Staffelbach, Bruno (1994), pp. 248.

[280] See Ashkanasy, N. M./Windsor, C. A./Treviño, L. K. (2006).

7.4.2.2 The Moral competence of the Employees in Line with Staffelbach

The moral competence of the employees can be subdivided into three sub-competencies based on Staffelbach.[281] First, one has to wish for the good and then to recognize the good.

1. **Moral attitude**

   If the good is not wanted by the employees, they will not have any thoughts about the consequences of their behavior. Because certain character traits are given, it can only be a matter of sensitization and the mediation of the ethical corporate guidelines, so that the employee recognizes what the company wants.

   This includes the inner willingness to recognize and take into account the rights and interests of other people, such as colleagues and other stakeholders, as fundamentally equivalent (affective component). But there are also situations in which one has to move emotionally into the situation of others. This requires empathy as a skill.

   A study of the moral development of apprentices has shown that there is a change of relationship between an existing moral sense of responsibility and the possibilities to stimulate it through more self-responsibility. If there is a sense of responsibility, the employees want more self-determination and this is also the prerequisite for a sense of responsibility.[282]

2. **Moral cognitive abilities**

   There are people who act without worrying about the consequences of their actions. This can be due to their attitude or the ability to recognize the consequences. What is needed here is an analytical ability to recognize cause-and-effect relationships. It is necessary to assess the spatial, temporal, and distant consequences of one's own actions. This includes the ability to achieve a certain mental distance,[283] intelligence, imagination as well as experience.

3. **Comprehension**

   The employee needs competence to exchange his opinions about the consequences of the company behavior and its evaluation with colleagues and other stakeholders in the context of a discourse according to the approach of discourse ethics or the ethical stakeholder analysis and then to reach a consensus result. For this purpose, employees need communication, co-operation and conflict management.

   However, ethical comprehension competence in the sense of discourse ethics is not strategic "bargaining," in which one interrogates, lies, tricks and manipulates,[284]

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[281] See Staffelbach, Bruno (1994), pp. 421.

[282] See Lind, Georg (1989), pp. 306.

[283] See Retzmann, Thomas (1997), pp. 297. See zum Rollenansatz von Rawls Rawls, John (1979), pp. 158 and 341, and in the original Rawls, John (1971), pp. 10, 12, 139.

[284] See Ulrich, Peter (1998), p. 13 and Göbel, Elisabeth (2010), p. 260.

or makes the assertion of one's standpoint in the sense of a rhetoric competition, but balances all interests for a socially (stakeholder-related) optimal solution, that is, a utility maxim taking into account the values and goods for each concerned.

For this purpose, the employee needs a real consensus, honesty, openness and mutual recognition in the sense of "argumentation integrity"by Blickle. Blickle et al. varied the violation of expectations in experiments with discussion participants and came to the following recommendations[285]:

1. Do not argue intentionally in uncompromising ways.
2. Do not justify your allegations.
3. Do not say something is true or objective, when you know it is false or subjective.
4. Do not seek excuses, to deny responsibility, or to defer.
5. Do not circumvent your own or foreign positions in a disassembling manner, for example in order to create exceptions.
6. Do not deliberately reproduce the meaning of your own or third-party contributions wrongly.
7. Do not place demands on the discussion or negotiation partner, if you know they are incapable of fulfilling them.
8. Do not discredit or ridicule the other.
9. Do not treat others as an enemy, so as to offend, provoke or intimidate them.
10. Do not allow other participants to be excluded, for example by deliberately clouding the issue, by refusing to discuss issues, or by using frequent technical terms.
11. Listen to the other person, evaluate his arguments in the weighing of goods with yours, and bring a counter-argument only after you have understood and validated their point.

The importance of comprehension competence must not be underestimated, because without a fair and open discourse, without an honest discussion, no optimal result for the company can be found.

The employees are socialized through the corporate culture as well as through role models, rewards and sanctions of the managers. The ethical influencing of employees via the mediation of values is also called value management (Wieland).[286] According to Wieland,[287] there are four levels of ethical consciousness, three of which are appropriate to convey values:

7.4.2.3 Levels of Ethical Awareness and Wieland Management

1. **Character**

[285] See Blickle, Gerhard (1996), pp. 116.

[286] See Wieland, Josef/Fürst, Michael (2002), p. 5 and Wieland, Josef (2014).

[287] See Wieland, Josef/Fürst, Michael (2002), p. 5.

The human being has an innate character, in which values are laid down indirectly as behavioral dispositions.

2. **Childhood Socialization**

In childhood man is socialized by his parents, that is, educated. Praise and blame, including sanctions, adapt his behavior to that desired by the parents. Parents also give him their value system through conversations and enlightenment. Added to this is socialization through the circle of friends and school. For the first time, society is given the opportunity to directly influence human development. There is often also the influence of religion via the parents and common church visits (communion, confirmation etc.).

3. **Socialization as an adult**

The socialization of adults (secondary socialization) takes place in the respective societal environment such as in the workplace, or depending on the religious character, the church may have influence.

4. **Self reflection**

Finally, the adult has the possibility to form his own reflection on moral values and define values for himself. This conscious assumption of values yields ethos.[288]

Is it possible to change employees as adults in their behavior? Insofar as the employees adapt themselves in the company environment, the group, they can also adapt to ethical requirements. Sociology speaks of a "secondary socialization".[289]

It has to be taken into account that an ethical training of the employees up to the 6th level of the Kohlberg model is indeed desirable and striking, but unfortunately also unrealistic. Even Kohlberg assumes that only a small part of people reach the top two ethical levels. A realistic goal seems to be the 5th level. In order to achieve this, it is necessary to highlight the benefits of ethical behavior for companies and society and to provide employees with an ethical armament for evaluating everyday situations. The first step in this direction is to inform the public and the companies about the productivity advantages of ethical behavior, thus gaining acceptance for ethical personnel development.

The task of ethical personnel development would be, as with the Kohlberg model, to strengthen the cognitive ability of the employees to moral judgment, that is, no indoctrination or ethical brainwashing. It changes the structure of judgment and not the value base. The employee then finds values using his own knowledge.[290] An instrument for this would be the Socratic conversation within the framework of ethics seminars. The employee should be able to select the morally correct action independently of his own advantages or disadvantages or company specifications and to persist in his viewpoint.

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[288] See Berger, Peter L./Luckmann, Thomas (1972), pp. 148.

[289] See Berger, Peter L./Luckmann, Thomas (1972), pp. 148.

[290] See Staffelbach, Bruno (1994), p. 249.

7.4.2.4 Ethics Seminars

In addition to the publication of ethical corporate guidelines, many companies use corporate ethics seminars to convey the company's ethical orientation. First of all, it is important to make the employees aware of their own ethical position. The already described "value clarification" method is used.[291] Again, the Socratic conversation can be applied as a method. Socrates applied a special open questioning technique to motivate people to self-knowledge (mäeutics or midwifery). Midwifery because the questions raised something from the interviewees that had already been there. This is a philosophical dialogue for the purpose of gaining an insight in an open-ended research process.

The goals and wishes of the employees are listed, chosen among alternatives, and the values hierarchy is derived from them. Alternatively, concepts such as social Darwinism, conventionalism, legalism, etc. can be put to ethical discussion. From the positions of the participants the values can then be worked out. Employees are also asked to apply these approaches to their business experience and to critically deal with these ethics concepts, in which their own attitudes become clear and they learn to critically question ethical positions. Ultimately, they should say what they would be willing to do for their values.

In order to provide employees with the implications of economic activity, role-playing games are particularly suitable, in which they assume the role of the affected person and argue for his or her interests in the group. It is customary to hold ethics seminars in the form of external workshops, in which, in addition to role-playing games (including, if necessary, planning games) case studies and discussions, ethical awareness is conveyed interactively. Basic ethical knowledge can be taught through lectures. Alternatively, presentations or group work can be selected as an intermediate form. Discussions of ethical dilemmas, in particular, inspire the employees with intensive discussions, reveal ethical attitudes and lead to a critical reflection on the morally appropriate solution, which also challenges their own standpoints.

In order to support the moral balance, workshops can be used with questionnaires that include previously elucidated ethical criteria or decision trees with handling options and their results. In addition, there are value tree analyses in which the values and norms as well as the goals of the employees or the company are transferred to a hierarchical tree structure according to their value and dependency. Test criteria can then be derived from this. Structural forms can be used to evaluate action options based on the criteria listed there, or to evaluate the ethical behavior of the workshop participants in their roles. Interdependent analyses can be used to record stakeholder relations.[292]

With these means, complex contexts can be disassembled, simplified and subsequently structured and analyzed. Ethical awareness is thus possible. However, most of the effects of an action are not workable and therefore not comparable. Since it is

[291] See Staffelbach, Bruno (1994), pp. 336.

[292] See Dahm, Karl-Wilhelm (1993), p. 3 and Staffelbach, Bruno (1994), pp. 302.

ultimately always a moral consideration of the consequences, there will also rarely be a unanimous agreement of all workshop participants. The comprehension competence can be increased by means of argumentation exercises, business games and role play, team development and group dynamics training (encounter groups, sensitivity training, etc.).[293]

7.4.2.5 Corporate Volunteering

In the sense of an ethical maturation or awareness-raising, so-called Corporate Volunteering can be especially useful for executives. In doing so, the employee is released from the company for a so-called social task. For example, a board could help one day to feed the needy or go on the street for the homeless. This also leads to an ethical increase in the awareness of leadership. A different life role allows previously unknown insights and identifications. Such a program signals a positive example in the company that ethical aspects are taken seriously. At many universities as a comparable approach, social learning as a compulsory subject was included in the curriculum.[294] The students take on social tasks as a project in groups.

7.4.2.6 Training-Near-The-Job

In the case of training-near-the-job, employees meet in circles in order to discuss ethical aspects of their work in the company. It is therefore an application of discourse ethics. Employees can be clear about the consequences of their own work through the ethical evaluation as part of the group discussion and also receive feedback from their colleagues. At the same time, the company's horizon is expanded.

An inclusion of external people is recommended if the expertise and experience with ethics seminars are not internally available or the authority, neutrality and objectivity of an external perspective is needed. This can be an advantage, particularly in the case of executive seminars and mixed workflows with employees, in order to overcome internal power structures.

In general, the company can increase ethical awareness and behavior by giving employees more room for decision-making, and more responsibility. Employees cannot develop when they are restricted by command and obedience.[295] As organizational measures, training-near-the-job offers employees the opportunity to be confronted with morally relevant conflict situations within the company. In this way, they can gather experience of cooperation and responsibility and communicate their ethical considerations.[296]

[293] See Staffelbach, Bruno (1994), p. 423.

[294] See Göbel, Elisabeth (2010), p. 264.

[295] See Retzmann, Thomas (1997), p. 301.

[296] See Porter, Michael (1993), pp. 814.

Summary
The goal of ethical personnel development is to increase the moral competence of the em-ployees. An immediate advantage is the avoidance of scandals and court proceedings and thus a better reputation. Indirect advantages, such as a higher level of employee satisfaction and ultimately higher productivity have already been shown above. Furthermore, as we have seen, the ethical preconditions are the basis for overcoming moral hazards, that is, the pursuit of corporate objectives by the executive without enriching the company at the expense of the principal. Ethics thus ensures motivation and productivity. Regular behavior evaluations as well as attitude and character evaluations should also reveal the target and actual deviations of the job requirements. These gaps are then closed by ethical personnel development measures. If this is not successful, the points must be changed internally or externally.

Questions of Comprehension
1. What are the goals of ethcial personel development?
2. Name and explain some instruments of ethcial personel development.
3. How far can the ethical awareness be influenced?

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Chapter 8
Ethics in Business Education

What Follows Why?
The way the world is viewed also influences people's behavior. Ideas and attitudes, including moral values, must be demonstrated and educated. In the following chapter we want to analyze what cultural factors are taken into account by economics and how management education enhances ethical behavior.

Learning Goals
You should be able to explain how ethical behavior is influenced by management education.

8.1 Cultural Factors in Economics

An article in the German newspaper Handelsblatt titled, "Economic Culture Revolution." describes the self-recognition that economics "was ignorant for a long time about cultural factors." Representing the ignorant "traditional" economy, the assertion of Nobel laureates George Stigler and Gary Becker was quoted from the end of the 1970s: "Economists who argue with cultural factors are just disguising the failure of their analysis." According to the article this verdict remained the dominant opinion until the late 1990s. American researchers were able to prove the influence of culture with a valid methodological effort. Professor Raquel Fernández from New York University, together with her colleague Alessandra Fogli, was able to separate cultural factors from classical economic factors of influence. They made use of a medical research approach called the epidemiological approach. When American doctors want to filter out environmental influences as the cause of, for example, heart attacks in Japanese, they compare the heart attack rates for Japanese patients who have emigrated to the USA with their genetically similar counterparts living in Japan. The economic scientists compared the tendency to engage in a particular profession for women born in the USA, but whose parents came from

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different countries. The political and economic conditions were the same for all subjects, yet they showed great occupational differences. The greater the participation in employment of the family's original country, the more likely the daughters born later in the USA were working.[1] Another research group, Guiso, Sapienza and Zingales were able to prove that the normative, positive formation of thriftiness was just as important in explaining country-to-country differences in thriftiness as the economic factors of influence.[2] Another study by Andrea Ichino and Giovanni Maggi confirmed that regional culture differences formed the economic behavior of people. They investigated for a large Italian bank why southern Italians took more sick leave than their northern counterparts. They discovered that the place of birth had a significant influence on calling in sick. Italians born in the south had significantly higher absentee rates, even if they worked for years in the north.[3]

What conclusions can be drawn from these new revelations of economics? First of all, they are not new revelations, they are at best merely statistic confirmation. The sociologist Max Weber had already shown the importance of culture in economic development in "The Protestant Ethic and the Spirit of Capitalism" in 1905.[4] Before that there were already references made to the idea. Cultural influences were, and are, the basis for cultural sciences such as sociology or behavioral research. Many of the new statistic revelations made with such effort can be derived logically through common sense and may even be called banal.

What is in fact new is the alarming admission of economics to have ignored cultural factors for decades. It shut out all of the influencing factors in its observable world that it could not examine and proove with quantitative factors. It simply ignored their existence and all economists who wanted to include them despite their incalculability were denounced and banned, as was expressed in the statement of the two Nobel laureates.

In the modern, free society, everyone should have the chance to develop however they desire. Everyone should at least have the chance to work their way up to being a millionaire, which is a central incentive for performance in the market economy. National wealth is then not statically in the hands of the few. According to the enlightenment all people are equal, at least in their basic rights, which makes the solution relatively simple in that the freedoms of one individual end where those of the others begin. If we were to leave it at that, this would be an idealistic illusion, leading neither to a functional nor a humane society. There would only be individualists who maximize their benefits and freedoms within the limits determined by the rights of others. Each person would create their own island of freedom and benefits. The result would be just millions of little islands of freedom and egoists. Society as a continuous entity, a community, would not exist. No one would do anything useful to others for the common good. No one would sacrifice himself for his family; no

[1] See *Fernández, Raquel/Fogli, Alessandra* (2005), pp. 552–561

[2] See *Guiso, Luigi/Sapienza, Paola/Zingales, Luigi* (2006), pp. 23–48.

[3] See Ichino, Andrea/Maggi, Giovanni (1999), p. 1057–1090 and Handelsblatt dated 19.02.07, p. 9.

[4] See Weber, Max (1905).

one would care for their parents in old age out of gratitude, or care for their children. Volunteer work necessary for a community would no longer be performed. Politicians would use their positions just to maximize their own benefit. No one would engage themselves for the good of the community, society, state or nation.

All modern societies have institutions and organizations, giving them order, and instilling discipline in their citizens to behave in the manner socially desired. As we have already shown however, this is not sufficient. For a society to function and for productive forces to develop, the appropriate social capital for the type of system order and economic stage of development must be available. This depends greatly on the attitudes of people required for societal or community cooperation. Norms, values and morality are important here, including attitudes towards the political and economic system.

It is clear that it really must be the opposite, and that the more freedom individuals have, the greater their morality must be. When political leaders and church no longer sanction people in relation to their moral behavior or missteps and when there are few predetermined rules, people must have already internalized socially desirable behavior, possessing inner values and social capital. The more modern the economy, the more important morals and values are for the development of productive forces.

The Sociologist Max Weber had already noted in 1905 that the source of a positive economic development in Switzerland, the Netherlands, England and parts of Germany was a Protestant or Calvinist influence.[5] The attitudes of people in a society towards economically relevant activities have been paid as little attention by economic science as the existence of general economic knowledge. What does it help in the case of Russia that a market economy system was introduced, if the people still behave as they did in the communist, planned economy? What does it help if a framework, such as a legal system with legislative and executive branch, if the judges can be bribed because they are not remunerated adequately? What does it help if a democratic framework is created like in Russia at the end of the 1980s and in Germany in the 1920s if people are politically passive and desire a strong leadership that takes care of their problems? If a system of order is neither accepted nor understood it has no future.

Cultural terms are not always exact, and are surely not solely responsible for an economic development. There are many cultural values that influence productivity, and on the other hand institutional framework conditions, or political order, play a role just as much as do macroeconomic variables such as monetary and human capital. One must therefore avoid normative conclusions from quantitative investigations and statements such as "the labor productivity of people A is greater than that of people B because people A are more willing to make an effort or work harder." The universal applicability claimed by this kind of statistic must be questioned, even if there is significance for a factor. Many factors are usually ignored, and it is meaningful to know how many people were questioned over what time frame. Associations are also problematic, since "not willing to perform" can be equated with "lazy," for example.

[5] See Weber, Max (1905); Ulrich, P. (1993), pp. 1168 and Noll, Bernd (2002), p. 166.

Ultimately the goal is to recognize the importance of soft facts, bringing the qualitative factors into a logical connection with other factors to affect higher productivity. Company management and state government must implement morals and ethics, as well as propagate and exemplify values for each individual. Opinion surveys can offer an indication, but no more than that, although they do show where improvement is needed. This should be easier for companies than a national economy. Economics is not an exact science, but we may hope that at least more value will be place on ethics, morals and norms. This hope may be deceiving, however. Because a quantitative proof was provided it has now been admitted that cultural values have an effect on the economy, but which values exactly and how the values coincide will remain unknown based on purely quantitative analysis. With even the most refined quantitative analysis there will always be many influential factors and connections, ethics in particular, that will not be included. Thinking and deriving in contextual forms remains impossible.[6]

8.2 Economics as a Natural Science?

The most striking thing about mathematics is that it always delivers precise results from the model assumptions and the model construction, and these results are evidence. The first economic pioneer to develop economic science into a scientific/mathematical discipline such as mechanics or hydrodynamics was Léon Walras (1834–1910) with his general theory of equilibrium. After the Second World War the later American Nobel laureates Paul Samuelson, Gérad Debruie and Kenneth Arrow ensured the breakthrough of mathematics in economics. This seemingly scientific precision was apt for a social science and continued to prevail in the following years. The mathematical trend was perfected in the USA in the following decades. With the gigantic further development of computer computing, enormous amounts of numbers were processed. It also allowed statistics as so-called econometrics to move into the economics sciences. In 1940, in the prestigious "American Economic Review" 3% of the pages were filled with mathematical formulas, today it is about 50%.[7] This did not, however, increase the practical significance of the essays. A well-respected CEO described the economics publications as a "vast

[6] "Business scholars could take a lesson from their colleagues in the discipline of psychology, which was stifling under the scientific model three or four decades ago. Psychological research then was dominated by rigorous, but ultimately unproductive, studies of reaction time. As long as psychology professors labored within a small area, they learned little that was of value to anyone. It was only after they began to apply their imaginations – and rigor – to much boarder problems that psychology began to make enormous strides. Not until respected psychologists dared to ask questions that mattered, whether or not they could be quantified in traditional ways, were groundbreaking studies undertaken, such as the Nobel Price – winning work of Daniel Kahneman and the late Amos Tversky on how people make financial decisions". Bennis, Warren G./O'Toole, James (2005), p. 4.

[7] See Wirtschaftswoche vom 9.02.2006, p. 31.

wasteland."[8] Meanwhile even in the USA, the pioneers of this orientation are critical. For Alan Binder, professor at the famous Princeton University, economics has become more mathematical than physics and the Nobel laureate for economics, Roland Coase, considers economic science to have been degraded to

> a theoretical system floating in the air with hardly any connection to what is happening in the real world.[9] Or As a method of economic analysis, econometrics are a childish game with figures that does not contribute anything to the elucidation of the problems of economic reality.[10]

This is where economic science strives to conceal its socio-scientific roots and to give itself the appearance of an exact science. Whatever is not measurable and calculable does not exist. Factors of influence such as qualitative soft facts are usually ignored. There is no gray area, just black or white. A lack of new discoveries, or only imprecise insights, is not something that can be marketed. What science wants to be constantly displaying its limits or inabilities? Habilitations or department chairs are not awarded for saying that one does not know. Whoever is searching for economic realities, for the truth, has a hard time of it on the job market for economic scientists. Technicians who show an exact science are in demand. Here it becomes clear how economic science attempts to hide its social science roots and appear as an exact natural science. Bennis and O'Toole talk of a "scientific model" that the social scientific economic science has borrowed from the natural sciences due to its "physics envy."

> The scientific model, as we call it, is predicated on the faulty assumption that business is an academic discipline like chemistry or geology. In fact, business is a profession, akin to medicine and the law, and business schools are professional schools – or should be.[11]

This is why the economic scientists think that the more complicated and complex the arithmetic model the better. The spread of computers and their calculation

[8] Quoted from Bennis, Warren G./O'Toole, James (2005), p. 90.

[9] See Wirtschaftswoche vom 9.02.2006, p. 31, translated into English.

[10] "Deluded by the Idea that the science of human action must ape the technique of the natural sciences, host of authors are intent upon a quantification of economics. They think that economics ought to imitate chemistry, which progressed from a qualitative to a quantitative state. Their motto is the positivistic maxim: Science is measurement. Supported by rich funds, they are busy reprinting and rearranging statistical data provided by governments, by trade associations, and by corporations and other enterprises. They try to compute the arithmetical relations among various of these data and thus to determine what they call, by analogy with the natural science, "correlations" and "functions" do not describe anything else than what happened at a definite instant of time in a definite geographical area as the outcome of the actions of a definite number of people. As a method of a economic analysis econometric is a childish play with figures that does not contribute anything to the elucidation of the problems of economic reality." Mises, Ludwig van (1978): The Ultimate Foundation of Economic Science, Jim Fedako: Correlating nonsense, http://antipositivist.blogspot.com/2007/02/correating-nonsence.html

[11] And further: "Like other professions, business calls upon the work of many academic disciplines. For medicine, those disciplines include biology, chemistry, and psychology; for business, they include mathematics, economics, psychology, philosophy, and sociology." Bennis, Warren G./O'Toole, James (2005), p. 2.

capacities has only augmented the trend. Meanwhile a verbal, logical, deductive thought process has no place in economic science and is scorned as unscientific. The increasing complexity has caused increased specialization. In order to present something new the models must be more complex. In order to achieve and to process this complexity, the new generation of economic scientists is forced to concentrate on a very narrow subject area and to present it repeatedly in minute variations. There has been no place at universities for a while now for generalists, in particular verbal generalists,.

> In fact, management professors seem to have an almost morbid fear of being damned as popularizers. Do they believe that the regard of their peers is more important than studying what really matters to executives who can put their ideas into practice? Apparently so. … Today it is possible to find tenured professors of management who have never set foot inside a real business, except as customers.[12]

In the meantime economics as a science has increasingly excluded the uncountable, qualitative implications of economic action because of the strong model orientation, and has separated itself from society as a self-contained discipline. There is little room for non-quantitative business ethics. Weber already criticized this tendency as a "fiction useful for theoretical purposes," which can not be made "the basis of practical evaluations of real facts." The economic instruments are multifaceted and, as a rule, "in another respect which is potentially important for human interests."[13]

Numbers are facts. However, this does not correspond to economic reality, since the economy is made by people. As we have seen, people do not always behave rationally, often emotionally and sometimes wrongly. Economic science is therefore not an exact deterministic science, but a spiritual and social science. Also, the inclusion of non-rational behavior in models does not alter the non-predictability.

The particular realization of this book is that morality and economic efficiency are not contradictory, but conditional. The economy can only work with people if the person is the center of attention. Economic laws and human characteristics must both be taken into account, with the economy as the sum of man-made, economically relevant institutions and organizations serving the human being. It is only in this way that it can be useful and gives meaning.

Ultimately the goal is to recognize the importance of soft facts, bringing the qualitative factors into a logical connection with other factors to affect higher productivity. Company management and state government must implement morals and ethics, as well as propagate and exemplify values for each individual. Opinion surveys can offer an indication, but no more than that, although they do show where improvement is needed. This should be easier for companies than a national economy. Economics is not an exact science, but we may hope that at least more value will be placed on ethics, morals and norms. This hope may be deceiving, however. Because a quantitative proof was provided it has now been admitted that cultural

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[12] Bennis, Warren G./O'Toole, James (2005), p. 4.

[13] See Weber, Max (1968), p. 529.

values have an effect on the economy, but which exact values and how the values coincide will remain unknown based on purely quantitative analysis. With even the most refined quantitative analysis there will always be many influential factors and connections, ethics in particular, that will not be included. Thinking and deriving in contextual forms remains impossible. [14]

8.3 Ethics in Business Administration

As was shown, a common feature of the crises was the immoral enrichment of managers at the expense of their companies and the system and thus the society. It has already resonated in many places in this book: The way the world is viewed is also influencing people's behavior. Ideas and attitudes, including moral values, must be demonstrated and educated. The early socialization phase plays an important role in the moral behavior of a person. For example, schooling has had a great influence on the ethical-cognitive development of human beings as has been empirically proven.[15] In this respect, economic academies have a special responsibility.

There are those who blame management training for catastrophes such as Enron, the subprime crisis etc. Thomas Lindsay, once Dean of the University of Dallas, points to studies before Enron that prove managers rarely fail economically or morally because of a lack of professional knowledge. What they are generally missing is what Aristotle calls "wisdom," to be understood as interpersonal capabilities and practical knowledge. In Lindsay's opinion the American education for managers is excessively subject-oriented, and the moral capabilities of the students is almost completely lost through unadulterated profit maximization. Aristotle said that true leadership is based on the ability to recognize and serve the good of the community. To train these abilities one needs much more than a professional education, one needs instruction in history, philosophy, literature, theology and logic.[16]

In this context, international criticism of economic education at universities is increasing. Göbel, for example, argues that it is all too often suggested that "one can

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[14] "Business scholars could take a lesson from their colleagues in the discipline of psychology, which was stifling under the scientific model three or four decades ago. Psychological research then was dominated by rigorous, but ultimately unproductive, studies of reaction time. As long as psychology professors labored within a small area, they learned little that was of value to anyone. It was only after they began to apply their imaginations – and rigor – to much boarder problems that psychology began to make enormous strides. Not until respected psychologists dared to ask questions that mattered, whether or not they could be quantified in traditional ways, were groundbreaking studies undertaken, such as the Nobel Prize-winning work of Daniel Kahneman and the late Amos Tversky on how people make financial decisions". Bennis, Warren G./O'Toole, James (2005), p. 4.

[15] See Lind, Georg (2010), p. 311.

[16] See Bennis, Warren G./O'Toole, James (2005), p. 95.

put oneself on a purely economic standpoint and hide everything else."[17] At universities, therefore, a rethink is necessary. Ethical considerations must not be excluded from the economic education.

With this background the internationally renowned business schools are in the defensive. Students, companies and the media blame the university for their graduates no longer being able to solve the complex, multidisciplinary problems of today's economy due to the wrong education. The universities fail to equip their students with useful abilities, to prepare them adequately as future managers and give them norms for ethical behavior, they say. Critique comes from within the university staff as well, such as from the Dean of the renowned Kellog School of Management at Northwestern University. Professor Mintzberg from the Canadian McGill University accuses the business schools of lesson plans unconnected to practical needs. According to Warren G. Bennis and James O'Tool from the Marshall School of Business at the University of Southern California, number games and simulations are used more in the universities to give the education a scientific touch, and simultaneously neglects a broad, practical training.[18] The columnist David Brooks thus complains:

> …our universities operate too much like a guild system, throwing plenty of people with dissertations at students, not enough with practical knowledge. Why aren't there more scholars … who teach students to be generalists, to see the great connections?[19]

As early as 1988, a commission of the American Economic Association for the assessment of the graduate education program feared that the programs would produce "idiot savants" who had no knowledge of the real economic problems.[20]

As was shown, the economics theory chose homo oeconomicus as a simplified model of thought. The Homo Oeconomicus, like the computer, is like the machine a purely rational being. Starting from a given information level, this creature always decides for the benefit-maximizing action and can thus be mathematically calculated. This gives students the impression that they have to maximize their own benefits, in order to be good, socially desirable. If households maximize their benefits and companies profit, this behavior is at the same time economically efficient and is therefore also a benchmark for economic education. Subcontractors always behave to maximize profits. Anyone who wants to become a successful entrepreneur should behave accordingly. Households make choices that follow benefit maximizing, as microeconomics teaches us. So this is the normal behavior as a private person.

This is the world that conveys economic science to young students in the Western industrialized countries. Many will say the world, and the people, are recklessly benefit maximizing. But what if men are neither good nor bad, and they are told to behave badly? Then the world would be worse than it could be.

[17] Göbel, Elisabeth (2010), p. 256.

[18] See Bennis, Warren G./O'Toole, James (2005). See auch Mintzberg, H./Gosling, J. (2004).

[19] Bennis, Warren G./O'Toole, James (2005), p. 5.

[20] See Hodgson, Geoffrey M. (2009), p. 1210.

Bad examples also corrode morals as well. It can be dangerous to continue to preach utility maximization with model thinking and to represent this as the only rational behavior. The consequence will be that people orient themselves towards these maxims of action and suppress their positive human qualities, such as compassion, willingness to help, general sacrifice and selflessness. Management education in particular must therefore ask whether it did not create these immoral managers, even indirectly, perhaps not even adversely affecting social development as a whole.

Many organizations are now active in the field of business ethics. For instance the Netzwerk Wirtschaftsethik (Network Economic Ethics) was founded in 1993, in which the churches, as well as representatives of business, politics and science, took part.[21] On the part of the students the demand for business ethics has intensified. This development is due to the immoral developments in the economy, which have been highlighted in the Enron scandal and the financial crisis. The Student Network for Ethics in Economics and Practice was founded by the students. The aim is to promote economic and business ethics in society and science, as well as to promote sustainable economics in theory and practice.[22] Sneep would like to encourage students, doctoral candidates, apprentices, as well as apprentices of all kinds, to think outside the boundaries of a "classical economy" and thus to show opportunities for business in the 21st century. Sneep called on the rectors of the German business schools to add business ethics as a compulsory lecture in the curriculum. The UN (Global Compact) launched an initiative in 2007 to stimulate research and teaching on business ethics, which has already signed nearly 500 universities around the world, with its Principles for Responsible Management Education (PRME).[23]

Harvard Business School formulates their community values:

> At Harvard Business School we believe that leadership and values are inseparable. The teaching of ethics here is explicit, not implicit, and our Community Values of mutual respect, honesty and integrity, and personal accountability support the HBS learning environment and are at the heart of a school-wide aspiration: to make HBS a model of the highest standards essential to responsible leadership in the modern business world. Our values are a set of guiding principles for all that we do wherever we are and with everyone we meet.[24]

Despite all these initiatives, business ethics is still not an integral part of economic science education.

What about management training in companies? Can an ethical behavior be created here? The mediation of ethical knowledge and awareness of the consequences of one's own actions are possible within the framework of seminars. Analytic capacity is not the problem among executives and the majority of employees.[25] It is questionable, however, whether the ethical motivation can be changed or produced. A problem arises from the market economy. The market only knows the do-it-yourself

[21] See http://www.dnwe.de/Ueberblick.html (3.05.2013).

[22] See http://www.sneep.info/sneep (3.05.2013). (author's translation)

[23] See http://www.unprme.org (5.05.2013).

[24] https://www.hbs.edu/mba/student-life/Pages/community-values.aspx (03/07/2018)

[25] See Göbel, Elisabeth (2010), p. 259.

mentality, i.e. reciprocity and a demand-driven efficiency or market fairness. According to the Kohlberg scheme, this corresponds to the second stage. The market is partly immoral. In the case of external effects, market failures occur, and the effects of economic trade on the welfare of an uninvolved third party. In addition to this, many companies have a strong hierarchy on the basis of orders and obedience, as well as a social appreciation of the company in the hierarchy. Against this background, Oppenrieder considers that it is possible for individuals to become negatively socialized with the entry into professional life and to re-develop in their moral consciousness.[26] A quotation from a board shows the discrepancy between ethical claim and reality:

> But inside the executives are aware of their ethical values, but they are often no longer able to get them out through the appliances. The companies have become appliances. The managers … are often driven by their system.[27]

This quotation also shows that, from the point of view of leadership, that the economic environment has become more unethical. From this point of view, the current problem of ethics cannot be solved with ethics seminars alone. It requires the use of all ethics tools in the company, an ethically oriented legislation and jurisprudence as well as a critical public. The companies are part of the nation. Politicians, too, must therefore be aware of their ethical social role.

Summary

All modern societies have institutions and organizations, giving them order, and instilling discipline in their citizens to behave in the manner socially desired. As we have already shown however, this is not sufficient. For a society to function and for productive forces to develop, the appropriate social capital for the type of system order and economic stage of development must be available. This depends greatly on the attitudes of people required for societal or community cooperation. Norms, values and morality are important here, including attitudes towards the political and economic system. The attitudes of people in a society to the economically relevant activities have been paid as little attention by economic science as the existence of general economic knowledge.

The way the world is viewed also influences people's behavior. Ideas and attitudes, including moral values, must be demonstrated and educated. The early socialization phase plays an important role in the moral behavior of a person. For example, schooling has had a great influence on the ethical-cognitive development of human beings, as has been empirically proven. In this respect, economic academies have a special responsibility.

[26] See Oppenrieder, Bernd (1986), p. 38 and Göbel, Elisabeth (2010), p. 256.

[27] Statement in the framework of an empirical study on the value propositions of top managers. See Buß, Eugen (2009).

Questions of Comprehension

1. Why are social aspects often not taught in business education?
2. Have moral aspects been sufficiently taken into account in your business education?
3. What would you suggest to foster ethical behaviour of managers?

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