

Business Ethics versus Economic Incentives
Contemporary Issues and Dilemmas

Praveen Kulshreshtha

Assistant Professor, Economics Area
Indian Institute of Management
Vastrapur, Ahmedabad 380 015, INDIA

Tel: (91) - (79) – 632 4864

Fax: (91) - (79) – 630 6896

Email: praveen@iimahd.ernet.in

ABSTRACT

This paper is based on my experience with teaching a course on ethical dilemmas faced by individuals, managers and businesses in contemporary societies. Modern economic thinking generally presumes that individuals and businesses in a society follow their own self-interest, or private economic incentives. The course highlighted the importance of ethical considerations for action that are based on consideration of others rather than one's own.

Four significant ethical dilemmas of modern societies, concerning Crime Reduction and Legalization of Drugs, Saving the Earth's Environment, Abortion and Ethics in Business were chosen for class discussion. The readings on ethics in business covered views by management experts such as Peter F. Drucker and David Vogel on the meaning, relevance and evolution of business ethics in modern societies. The pedagogy of the course consisted of lectures and group discussions, during which relevant ethical issues were analyzed by using real-world examples and cases.

In a rapidly globalizing economy, Indian managers are likely to confront complex ethical concerns. Therefore, Indian managers need to acquire a deeper knowledge and understanding of ethics in business. A course on business ethics in India should aim to enhance students' understanding of ethical behavior, keeping in view the globalization process that is influencing the functioning of Indian firms today.

Business Ethics versus Economic Incentives *Contemporary Issues and Dilemmas**

* An earlier version of the paper was presented at the *National Workshop on Teaching Business Ethics*, held at *Indian Institute of Management Bangalore* during *May 23-24, 2002*. I thank the workshop participants for their helpful comments and suggestions.

*"And what is good, Phædrus,
And what is not good...
Need we ask anyone to tell us these things?"*

*-Robert M. Pirsig, "Zen and the Art of
Motorcycle Maintenance: An Inquiry into Values"
(Morrow, William & Co., 1974)*

I. Introduction

Since time immemorial, questions concerning ethical behavior and morality have been the focus of philosophical thinking and debate in virtually all major civilizations of the world. In contemporary societies, not only ordinary individuals but corporations and their managers face complex ethical concerns and dilemmas in their daily, routine affairs. This paper is based on my experience with teaching a course that focused upon some of the major ethical issues and conflicts which individuals, businesses and their managers confront in modern times. I taught the course to a class of twelve senior undergraduate students at Pamplin School of Business, Virginia Polytechnic Institute and State University (or Virginia Tech), U.S.A., during January to May, 1997.

Modern economic thought is largely based on the assumption that individuals and businesses in a society always pursue their material self-interest or more generally, private economic incentives. Hence, it is generally assumed that businesses maximize their economic profits and managers of firms usually work towards achieving this objective. What is notable regarding modern economic analysis is its virtual neglect of ethical and moral considerations in business, even though current policy debates often focus upon ethical violations and moral improprieties within business organizations.

What is even more striking is the insufficient attention paid by economists to ethical dilemmas of individuals and managers today.

The course highlighted the significance of ethical and moral considerations of behavior in situations where the ethical mores of a society are in conflict with individual actions based on solely on private economic incentives. Four ethical dilemmas, each highly significant in modern societies, were chosen for class discussion. These were dilemmas concerning Crime Reduction and Legalization of Drugs, Saving the Earth's Environment, Abortion and Ethics in Business. Class discussions and lectures were based on readings that covered important ideas of economists and other social scientists on each topic. Real-world examples and cases were used to analyze specific ethical issues pertaining to each dilemma. Relevant public policy issues were also discussed following the above analyses.

To understand the meaning and relevance of business ethics in contemporary societies, I relied upon the ideas of two key experts on the subject: David Vogel and Peter F. Drucker. Vogel (1991) has focused upon the emerging relationship between business ethics and economic incentives (or profits) in business. In contrast, Drucker (1981) has discussed the relevance of ancient ethical principles, such as ethics of prudence and self-development (which dates back to Aristotle) and ethics of interdependence (expounded by Confucius), to modern business ethics. Both authors have stressed the difficulties associated with developing a universally acceptable notion of good behavior in business.

The next section reviews Vogel's ideas concerning ethics and incentives in business that were discussed during the course. Section III discusses Peter Drucker's notion of business ethics in contemporary societies. Section IV explains the course pedagogy in more detail. Section V summarizes and concludes with a discussion of the importance of teaching business ethics to Indian managers.

II. Ethics and Incentives in Business

David Vogel has pointed out that in modern capitalist societies, profit orientation of firms is not considered bad *per se*, as opposed to medieval times, when Catholic theologians in the west considered any form of profit-making as bad. Maximization of economic profits is a legitimate business goal today, provided it results from greater economic efficiency or productivity of a firm. In other words, profit-making is ethically justified so long as it benefits society. Hence, businesses which gain profits by extortion or other means of profiteering and more generally, do not contribute towards the social or public good, are considered socially irresponsible and immoral.

Although critics of business ethics continue to believe that profits and morality are negatively related and businesses often behave irresponsibly to accumulate profits, modern business organizations have argued that good ethics is essential for success in business. The argument put forth is that a firm without sound ethics will eventually be punished by its suffering customers and employees and therefore, its profits will shrink over time. This is meant to provide an incentive for a firm to act socially responsibly or 'ethically', apart from improving its productivity and efficiency to succeed in business. A strong corollary of this argument is that modern businesses which strive to be successful

have to ensure that their managers and employees are not only efficient but socially responsible and moral as well.

Hence, the business community today strongly believes that 'good ethics is also good business'. It is interesting to note that this belief is 'self-fulfilling': if a large number of managers in a society are convinced that good ethics is good business, then financial success of managers is likely to be positively correlated with ethical behavior of managers. However, if many managers believe that there is a trade-off between business ethics and profitability, then successful managers are less likely to be socially responsible or ethical.

As Vogel has shown, the above belief raises some important concerns regarding the rationale for business ethics. According to the above belief, the interest of business and society tend to coincide in the long-term and therefore, it is in the "enlightened" or long-term self-interest of a firm to be ethical. However, this belief is not very useful in providing guidelines for correct action in situations where the material self-interest of a firm (i.e. its economic profits, or shareholder wealth) is in conflict with the society's interest (for example, when a factory manager finds it cheaper to pollute a nearby river rather than reduce its pollution in society's interest). Thus, the ethical dilemmas of management cannot be resolved easily in the short-run.

Another objection to the idea of equating long-term or "enlightened" self-interest of firms with ethics is that the need to teach business ethics to managers can then be questioned, as follows: If being ethical is identical to pursuing a firm's long-term

interest, then managers of a firm could behave ethically simply by learning more sophisticated ways to maximize the firm's economic profit, thus making the teaching of business ethics redundant! Hence, the relationship between ethics and incentives in business continues to be ambiguous and paradoxical even today.

III. What is Modern Business Ethics ?

Peter Drucker has argued that any meaningful definition of contemporary business ethics must incorporate certain principles embedded in the ethics of prudence or self development and the ethics of interdependence, which were articulated and practiced centuries ago.

Ethics of Prudence and Ethics of Interdependence

According to ethics of prudence or self-development, any individual can be a 'leader' in a organization, regardless of rank or function, by giving examples of right or ethical behavior and by avoiding wrong behavior whenever wrong behavior is clearly understood. Hence, for instance, managers can 'set the tone', 'create the spirit' and 'choose the values' for the employees of their organizations. In many situations, ethical dilemmas of modern managers can be defined and understood in terms of the ethics of prudence.

In contrast, the Confucian ethic of interdependence focuses on right and wrong behavior in societal relationships. According to this principle, right, 'sincere' or ethical behavior in relationships is the one which maximizes each party's benefits. Hence, ethical behavior creates a relationship that is harmonious, constructive and mutually beneficial. Wrong,

'insincere' or unethical behavior arises when one party exploits the other by using its power in the relationship. For instance, 'sexual harassment' at the workplace would be considered unethical under the ethic of interdependence. In general, unethical behavior results whenever 'power' enters a relationship that is meant to be based on function alone. Thus, wrong behavior leads to conflict-ridden, destructive and exploitative relationships.

Modern Business Ethics

Drucker has emphasized that in contemporary societies, ethics or 'sincerity' of organizations is as important as their efficiency or performance since both individuals and society depend crucially on organizations for employment and prosperity. Thus, Drucker argues that a modern business ethic must be based on a clear understanding of fundamental relationships in organizations (such as employer and employee, superior and subordinate etc.) and must specify universally applicable rules of behavior for managers and employees of organizations. A modern organizational ethic must also define right or sincere behavior leading to harmonious and productive relationships within organizations. Lastly, a business ethic today must also create a large number of 'leaders' in organizations regardless of their function and ranks, as defined by the ethics of prudence or self-development.

IV. Course Pedagogy

As mentioned earlier, the pedagogy of the course consisted of lectures and group discussions in class, based on readings that covered important ideas of economists and other social scientists on the four ethical dilemmas chosen for the course (namely, Crime

Reduction and Legalization of Drugs, Saving the Earth's Environment, Abortion and Ethics in Business). Each dilemma was analyzed by using real-world examples and cases. Public policy concerns were also debated by drawing upon the above analyses.

To encourage active class participation and team learning, students were divided into three groups, each consisting of four students. Before every class discussion, members of each group were instructed to discuss specified articles and cases among themselves outside the class. During every class discussion, issues concerning one of the ethical dilemmas were discussed and debated among the three groups. After every discussion, each group was required to submit a six-to-ten page written assessment of the topic of class discussion. Students were graded, both individually and as a group, based on their oral arguments during every class discussion and the written assessment of their group on each given topic. In addition, to provide incentives for every student to put in the necessary effort and participate actively in group discussions, each student also received peer evaluation and feedback from all the other members of his/her group following each class discussion.

In the feedback given at the end of the course, students indicated that they enjoyed the group discussions and felt that the discussions enhanced their understanding of each topic significantly. Students also pointed out that receiving feedback from their peers after every class discussion had a positive impact on their commitment, hard work and preparation for group discussions. Overall, the students felt that the course gave them an opportunity to appreciate, discuss and understand the practical importance of ethical concerns in the modern era of competition, economic efficiency and growth. Students

also opined that although accounting for ethical concerns raises the complexity of decision-making required of them as individuals and managers, learning to deal with ethical dilemmas is essential if they are to become good citizens and 'leaders' in modern organizations.

V. Conclusion

Modern economic analysis assumes that individual and managers of firms always follow their material self-interest or economic incentives in deciding how to act. Ethical and moral influences on their behavior are largely neglected by modern economists. The course discussed here focused on the conflict between ethics and economic incentives, especially in contemporary businesses. It was shown that the tension between ethics and incentives cannot be resolved easily, even if business ethics and economic incentives (or profit-seeking) converge in the long-term. It was also argued that a modern business ethic must clearly define right or ethical behavior while laying down general rules of conduct within organizations and thereby promote fruitful and harmonious relationships at work. A modern organizational ethic must also encourage managers and employees in organizations to become 'leaders' in exemplifying ethical behavior.

In a rapidly globalizing economy, Indian managers are likely to confront complex ethical issues and dilemmas, just as their western counterparts have encountered in their domestic and international contexts. Therefore, Indian managers must acquire a deeper knowledge and understanding of business ethics in the current, global context. A course on business ethics in India should aim to enhance students' understanding of ethical

behavior in business, keeping in mind the ethical dilemmas that challenge Indian firms in today's globalized world.

REFERENCES

Drucker, Peter F., "What is 'Business Ethics'?", *The Public Interest*, No. 63, Spring, 1981, pp. 18-36.

Vogel, David, "Business Ethics: Past and Present", *The Public Interest*, No. 102, Winter, 1991, pp. 49-64.