Ethics Underlies Decisions on Risk Management

We have a dear friend and colleague who recently embarked on a quest to address the challenge of ethics in business from an academic setting. His intent is to utilize the academic platform to continue to research, refine and recognize those practices that assure high business ethics.

We wish him the best and hope that part of what he accomplishes is unraveling the mysteries of how the best intended business ethics go wrong. As an example, well before Enron and Arthur Andersen LLP unraveled in the first part of this century, there existed a body of knowledge that emerged from the Wall Street scandals of the 1980’s that had as its theory the notion that Boards of Directors and senior managers should manage a company with all stakeholders in mind (Marcoux, May June 2000).

Stakeholders are defined as shareholders, employees, suppliers, customers and communities in which the company operates. That theory is most closely associated with R. Edward Freedman, Olsson Professor of Applied Ethics at the University of Virginia's Darden School who, later in the early 2000’s, some would argue had developed a theory that creates an unevenness of the interests of “stakeholders” with interests of equity shareholders of a company.

The use of stakeholder theory in making decisions on deploying capital runs counter to shareholder theorists like Milton Friedman, the Nobel laureate economist, who espouse that senior managers ought to serve singularly the interests of the company’s owners, the shareholders. The shareholder theorist argument is that improvements for non-shareholder “stakeholders” occur as side constraints to the improvement in a Company’s value.

We use this example of conflicting business ethic theories to highlight our firm belief that business ethics drive risk management decisions made by Boards of Directors. Your business ethics are best quantified in the Board of Directors’ “Tone at the Top” that permeates policies, procedures and investment decisions of your company.

It is this “Tone at the Top” that should be manifested in each decision of the Board of Directors and that should be a key item on the list used for annual internal audits.

We cannot overestimate the value of having a robust conversation among your Board members of the definition and articulation of the proper business ethic for your company.

Such a discussion of business ethics should result in the definition of the “Tone at the Top” of your company AND it should be a basis for creating the “Risk Appetite” for your company.

(Business Ethics Gone Wrong, Alexei Marcoux, Cato Policy Report, May/June 2000 – Vol 22, No. 3)