Adam Smith problem offers ethical answers

by Tim Costello

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I am frequently asked the question: Can it be profitable to be ethical?

Usually, there is a desperate hope for a neat synergy that says: Yes profit matches shareholder matches stakeholder. No conflict between them and the question is answered.

Business has always been quick to sniff profit, and if it is profitable to be ethical then great, let's get on with it. But it's not that simple, as the past 20 years have borne out.

In the 1980s, Gordon Gekko and the mantra "greed is good" represented a particular culture that virtually celebrated ruthlessness, without being troubled by conscience or ethics.

In the 1990s, a new doctrine permeated business that business was morally neutral, value-free.

And if business was morally neutral, there was no embarrassment in maximising shareholder wealth not in an exaggerated '80s style with machismo and shame, but as a proposition that moral neutrality can give us a clear focus to maximise shareholders' wealth.

Based on this doctrine, there's no need for business to give its wealth directly to the community. Maximise profit instead, so shareholders could bestow it wherever they wished in the community.

In the late 1990s it became clear there was no value-free place to stand, no neutrality for business. This is clearly illustrated by events at James Hardie, facing community censure over its approach to limiting liability for compensation to asbestos victims.

Like other companies found to have misled the community, James Hardie has found there is no neutral place to stand.

Over the past few years a new doctrine has emerged the "triple bottom line" as the key to a company's sustainability.

As John Elkington, who coined that phrase in 1991, said: "The other stakeholders, mainly the community, society and the environment, are profoundly important stakeholders, and their well-being is the only context in which sustainable wealth is made."

This doctrine emphasises that business is part of the community. It is in a relationship not just with shareholders, but with stakeholders.

Again, James Hardie illustrates the importance of this dual relationship and the problems that arise when the well-being of community stakeholders is disregarded.

There are five reasons this doctrine has emerged: the increasing transparency of business affairs; improved communications in a global world; extensive social change in the last decade; the increased role played in the economy by the private sector; and the realisation that global business is not something apart from society.

So there have been significant shifts over the past 20 years from greed is good, to neutrality, to today, where business is no longer neutral but in partnership with stakeholders.

We are in a different paradigm. But how committed is business to seeing through what this paradigm implies?

Adam Smith, the father of laissez-faire capitalism, provided a framework that I believe to be at the core of this paradigm: "Human beings are simultaneously self-regarding and other-regarding."

Most who have read Smith have understood instantly what he means by self-regarding. It covers the private profit motive, profit and self-interest that is mediated through the brilliant mechanism of the market, with billions of transactions every day. Indeed, no centralised or other system of planning, allocating preferences and distributing resources, can match it.

In picking up this part of Smith the laissez-faire principle we actually understood the truth of his first limb, that is, that humans are self-regarding.

Business understands this well and has led on this clearly.

But the second limb is where the great intellectual and personal challenge is for the corporate sector. "Humans are simultaneously other-regarding." The "other" being environment, community, attention to spiritual non-visual materials, for instance. The other is the stakeholders referred to earlier.

But can we still find help from Smith? Interestingly, he was a moral philosopher before he was an economist.

In *The Theory of the Moral Sentiments*, written before *The Wealth of Nations,* Smith says essentially that the foundation of a good society, a virtuous society, is moral sympathy. Today we would recognise this as empathy.

According to Smith, the foundation for a good society is a strong sense of connection to and responsibility for one another. Markets will create wealth, but they will not create a good society, or virtue.

Markets depend on a foundation of moral sympathy and sentiment, connection, responsibility, which is spiritual and social. Those things are the foundation because they are the "other".

Smith essentially says markets don't have morals. They will create wealth, but they won't create it evenly, distribute it fairly, or create a virtuous society.

Accordingly, corporations and businesses now need people who can balance the other with the self people who cannot just conceptualise but who have the authority to run their operations in terms of the other.

Philosophers since then have observed that the more Smith has been emphasised in terms of the self, the faster is the fragmentation of the other.

Many societies, as in the West, have solved the problem of supply but found themselves faced with social dislocation: an epidemic of depression, high youth suicide rates, drug addiction and marital breakdown.

Why is this? Philosophers call this "The Problem of Adam Smith" because the more we emphasise just one limb, the more we risk fragmenting the other. Individuals operating out of pure self-interest become atomised individuals lacking in sympathy, connection and social sustainability.

This is where we have to see corporations in the debate. They are not just the first limb of Adam Smith. They are beginning to understand that sustainable business happens in communities that are not fragmented. They need to be socially and environmentally aware of the context that surrounds them, the stakeholder, which is the other.

This is very important, ethically. If it is simply self the financial bottom line, whatever the other rhetoric there will be profound disillusionment and, ultimately, damage to the bottom line.

When the price is low the ethics are simple. But when it is $10,000 or $1 million in a culture that only knows Smith's first limb, the ethics seem to become a lot more complex. I don't think the ethical issue has changed. What's changed is the price tag.

But I understand why people get confused, and I understand why business which asks if it is profitable to be ethical when the price tag is high finds it difficult to find the answer.

There are no prescriptive answers to these dilemmas, but there is an answer is to be found in holding together both limbs of Adam Smith's prose.

The challenge for the James Hardies of this world is to bring both limbs together to provide for the other they have damaged while keeping the self afloat. And ultimately the other will be further damaged if the self, in this case, is unable to survive.

People whether they are corporate directors, finance managers or consumers are simultaneously self-regarding and, to use Smith's words, other-regarding self-seeking and other-seeking.

In that balance lie some of the answers to good corporate practice, good business and good ethics.

Tim Costello is chief executive of World Vision Australia. The above is an edited version of his address to the Institute of Company Directors on September 3.