Shareholders and Business Ethics

Having completed this chapter you should be able to:

- Describe the nature of shareholder relations to the corporation.
- Explain the rights and the duties of shareholders in the context of corporate governance.
- Explain differences in corporate governance models and codes in various parts of the world.
- Identify the ethical problems arising from the company–shareholder relationship.
- Evaluate the ethical implications of globalization for company–shareholder relations.
- Critically evaluate the roles of shareholder democracy, shareholder activism, and responsible investment in promoting ethical business behaviour.
- Critically evaluate the role of sustainability indices and alternative forms of ownership in influencing corporations towards sustainability.

Key Concepts

- Corporate governance
- Executive accountability
- Board diversity
- Insider trading
- Cryptocurrency
- Shareholder activism
- Socially responsible investment

INTRODUCTION: REASSESSING THE IMPORTANCE OF SHAREHOLDERS AS STAKEHOLDERS

As we saw in Chapter 2, there are strong voices out there (for instance, Milton Friedman 1970) arguing that corporations exist, and indeed act, solely for the benefit of shareholders. The pursuit of dividends and increases in share prices to satisfy financial markets are major features of the dominant capitalist model of value creation—but have also been widely cited as crucial contributory factors influencing firms to play fast and loose with business ethics. Indeed, as Stout (2016) argues, the corporate focus on only maximizing shareholder value is unnecessary, unworkable, and destructive!

Even if we adhere to dominant views of shareholder dominance, nothing has brought ethical issues more attention than the financial crisis that began in 2007. For instance, between October 2007 and October 2008, shareholders investing in companies traded on the New York Stock Exchange lost on average 40% of their investments (Nanto 2008). As many of the reasons for this crisis have a strong ethical dimension (such as lending practices in the US mortgage industry), business ethics is now a core consideration for some investors, shareholders, and employees-as-shareholders. Other people point to the expansion of socially responsible investment and the emergence of various indices of 'sustainable' stocks to suggest that shareholders are interested in societal good as well as their own self-interest. Whichever way you look at it, the role of shareholders is fundamental to understanding business ethics, and as such they are the first stakeholder group that we will focus on in this second part of the book.

We first discussed the role of shareholders in the corporation (albeit quite briefly) in Chapter 2 when we introduced the idea that while shareholders have a crucial stake in the corporation, this has to be understood within the context of other stakeholders, such as employees, consumers, and suppliers. In this chapter, we will investigate the finer nuances of this perspective. While maintaining support for a broad stakeholder perspective, we will examine the contention that shareholders, in some way, have a unique and superior claim upon the corporation. This relationship, as we shall see, confers certain crucial rights on shareholders, as well as imposing some quite important responsibilities in terms of the governance and control of corporations. By examining this relationship in some detail, we will provide the all-important context for discussing the various ethical issues that arise in shareholder relations, including insider trading, executive pay, and money laundering.

As we shall explain, both the impetus and the resolution of these issues and problems are shaped by certain national and contextual characteristics of corporate governance. We shall, therefore, go on to look at how shareholder relations vary quite significantly in different regional contexts. This will allow for a deeper understanding of the relationship between globalization and shareholder rights and responsibilities. Such issues have received a growing amount of attention due to the rapid global spread of the financial crisis in the late 2000s. We shall therefore move on to discuss the broader issues surrounding shareholder and stakeholder accountability before finally taking a look at how shareholders can use their unique position to address the question of sustainability of corporations.

SHAREHOLDERS AS STAKEHOLDERS: UNDERSTANDING CORPORATE GOVERNANCE

At the beginning of modern capitalism, and throughout the 19th-century Industrial Revolution, the common pattern of governing companies was a very simple one. At that time, industrialists, such as the Cadburys in the UK and the Thyssens in Germany, both owned and

managed their companies directly. Today, except in very small businesses, owner-managers are considerably rarer. Some exceptions to this include David and Charles Koch in the US and Richard Branson and his Virgin conglomerate in the UK. However, the common pattern in large corporations is a separation of ownership and management functions. In fact, this separation is at the heart of modern capitalism: owners no longer have a personal relationship to 'their' corporation, but rather they buy a 'share' in the corporation and expect the managers and employees of the company to run it in their (and other shareholders') interests.

The debate about the separation of ownership and control dates back at least to the 1930s and the landmark publication by Adolph Berle and Gardiner Means (1932). This debate essentially problematizes the notion of ownership when applied to corporations. In our everyday life, to own a bike, or a car, or even a house implies that we are able to do with our property pretty much whatever we like, and therefore can exert a considerable amount of control over it. After all, as we discussed in Chapter 2, the right to property is one of the fundamental rights of citizens. If I want to paint my bike green, ride it down the street, or even completely destroy it, then I can.

However, with regard to the ownership of corporations there are some crucial differences (see Parkinson 1993: 56–63; Monks and Minow 2011):

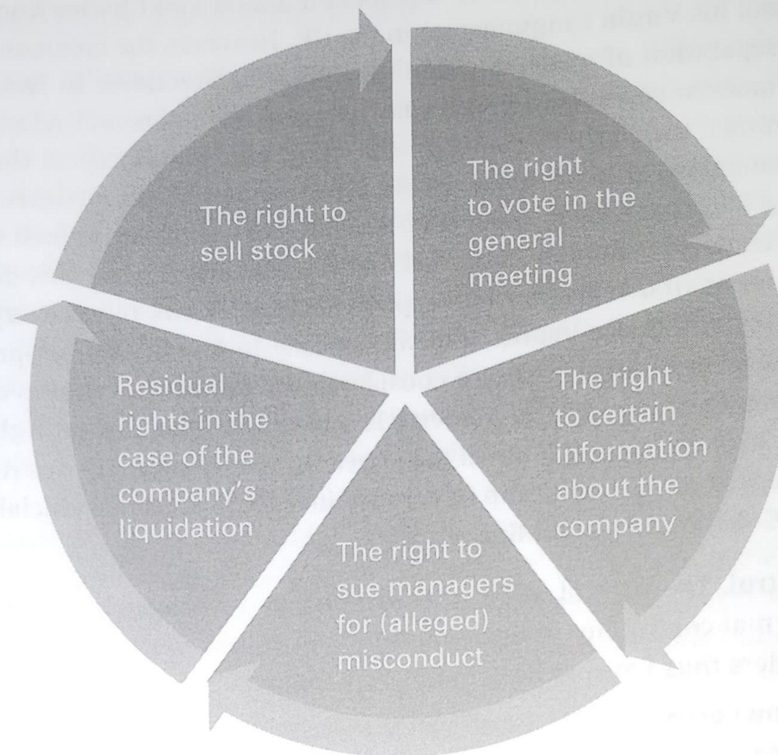
- Locus of control. The control of the owned property no longer lies in the hands of the owner. The actual control lies in the hands of the directors, the board, or another committee. Shareholders thus have, at best, indirect and impersonal control over their 'property'.
- Fragmented ownership. There are so many shareholders of a corporation that one individual could hardly consider themselves to be the owner in the same way that the plumber next door owns their own company.
- Divided functions and interests. Shareholders have interests that are not necessarily the same as the interests of those who control the company. Shareholders might seek profits, while managers seek growth. Furthermore, a shareholder has no real task and responsibility regarding their property apart from keeping a piece of paper that entitles them to a share in the company.

Given this somewhat modified interface between shareholders and directors of corporations, we can analyse their relationship a bit more closely. Obviously, the primary consideration for shareholders is the protection of their investment that, in the given context, amounts to certain specific rights (Figure 6.1).

Most notably, these rights do not include the right to a certain amount of profit or dividend; this is not only subject to the effort and skill of the management but is also—even if the company is profitable—dependent on the decision of the other shareholders in the general meeting. As Fox and Lorsch (2012) argue, shareholders contribute three resources to corporations: money (the provision of capital), information (in the guise of stock market trends and analysis), and discipline (keeping managers in check). Managers, on the other hand, are entrusted with the duty to run the company in the interest of shareholders. This general duty breaks down into various more specific duties (Parkinson 1993: 76–100):

- **Duty to act for the benefit of the company.** This obligation can be interpreted both in terms of short-term financial performance and long-term survival of the company. Principally, it is for the shareholders to decide at which level they want the company to perform; however, managers have a considerable amount of discretion in actually implementing this duty.

Figure 6.1 Shareholder rights



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- **Duty of care and skill.** Living up to this duty implies that managers seek to achieve the most professional and effective way of running the company.
- **Duty of diligence.** This last duty is the most general one and, as a rather legally flavoured term, 'refers to the expected level of active engagement in company affairs' (Parkinson 1993: 98). Consequently, this is the broadest way of establishing pressure on managers to invest every possible effort in running the company in the most successful way.

Clearly, the duties of managers are rather broadly defined. After all, one of the main tasks of a manager is to manage the 'property' of shareholders in their interests. This involves so many things that it is hard to pin it down to concrete activities and initiatives: which strategies, which products, which international investment projects will add to the success of the corporation? These questions are already hard to tackle for an insider, let alone for a shareholder who has only a little knowledge about the internal workings of the corporation and the finer specifics of its products, markets, and competitors.

The relationship between shareholders and the company is therefore defined by relatively narrow, but well-defined, *rights for the shareholder* and far-reaching, but rather ill-defined, *duties for managers*, or for the firm in general. It is no wonder that this situation has always been a delicate one and that conflicts continue to plague the relationship between managers and shareholders. Such conflicts focus on the nature of corporate governance (Parkinson 1993: 157). Corporate governance includes various rules, processes, and structures that enable

shareholders to exercise direction and control over managers. This includes how they can influence goal definition, supervision, control, rewards, and sanctioning of management. In the narrow sense, this just focuses on shareholders and the senior executives of a corporation, but in a broader sense, it also encompasses other stakeholders that might have a legitimate role in directing and controlling managers.

> **Corporate governance** The rules, processes, and structures through which corporations are directed and controlled in the interests of shareholders and other stakeholders.

CORPORATE GOVERNANCE: A PRINCIPAL–AGENT RELATIONSHIP

At first glance, it might seem unlikely that corporate governance should bring up too many ethical issues. After all, shouldn't shareholders and senior executives want the same thing, namely a growing, profitable company? Let us look at some high-profile governance scandals to see just what some of the problems could be:

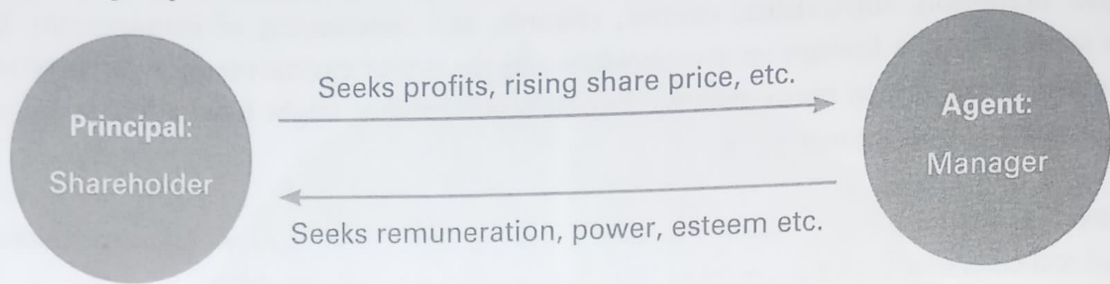
- Two weeks after taking over as CEO of Japanese electronics company Olympus in October 2011, Michael Woodford discovered that the company had hidden $1.5 billion of investment losses and illegal payments in a so-called 'tobashi' (concealment) scheme. When he exposed the problem he was immediately fired as part of a cover-up by longstanding board members. The scandal wiped out 75% of the stock market valuation of the company.[1] How was it possible that senior management could hide such an amount of losses from shareholders and persist in covering up their past mistakes?
- In 2014, General Motors (GM) faced a lawsuit from its shareholders, alleging securities fraud in the way that the company had handled a recall of 2.5 million cars due to a faulty ignition switch. The company had allegedly known about the problem for more than ten years, resulting in, by some estimates, up to 150 people being killed in accidents. How was it possible that GM could conceal the problem for such a long time from its 'owners', who suffered significant losses when the scandal finally broke in 2014?
- In 2018, British facilities management and construction services company Carillion entered into compulsory liquidation amidst £1.5 billion of accrued debt. Employing over 43,000 employees globally, Carillion was responsible for some of the world's most iconic buildings, such as the UK's Tate Modern and the Yas Viceroy Abu Dhabi Hotel. It also held responsibility for large public sector projects, including the building of hospitals and the management of schools. The collapse of Carillion was seen to be a corporate governance failing. Calls to encourage more transparency in corporate board decisions and to 'toughen' up UK governance codes ensued. How had Carillion managed to continually win valuable government projects in the wake of profit warnings and debts?

THINK THEORY

Think of the duties of managers to their shareholders from the perspective of ethics of duty (Kant's categorical imperative test). Apply this theoretical lens to the three incidents described above.

Visit the online resources for a suggested response.

Figure 6.2 Agency relation between the manager and shareholder



The essential problem here is that firm–shareholder relationships cannot be so easily framed in a contract that neatly states rights and responsibilities. As authors like Jensen and Meckling (1976) have shown, the relationship is a so-called *agency relation*. This means that the shareholder is a *principal* who contracts management as an *agent* to act in their interest within the boundary of the firm. **Figure 6.2** presents a very basic view of the relationship between manager and shareholder using this framework. Firms are much more than just boards, managers, shareholders, and debtholders, but situated within complex political and regulatory environments. This harkens back to our discussion of stakeholder theory in Chapter 2.

Shareholders want the managers in the firm to perform a certain task for them. As a principal, they want managers to do certain things with their property. Managers as agents, on the other side, also have their own interests. Agency relations are special relationships due to two features that are by no means necessarily common for all other manager–stakeholder relations (Shankman 1999):

1. There is an inherent *conflict of interest* between shareholders and managers. Shareholders want profits and increases in share price, which require major effort on the part of managers, and may suggest low salaries (i.e. the more managers are paid, the lower the resulting profit for shareholders). Managers want to have high salaries and might pursue power and prestige to the detriment of shareholder value. Consider the fact that acquisitions and mergers in the most competitive financial markets such as the US, UK, and Canada typically provide no additional value to shareholders and in fact often erode shareholder value (Alexandridis, Petmezas, and Travlos 2010).
2. The principal has only limited knowledge and insight into the qualifications, actions, and goals of the agent, something economists refer to as an *informational asymmetry*. The shareholders of Olympus and GM in our examples above might have been happy with the profitability of their companies, yet they only had limited insight into what managers were doing and the risks this created for them.

It is the combination of these two characteristics that makes shareholder relations with managers, and the whole issue of corporate governance, so precarious. Indeed, conflicts of interest and informational asymmetry can be seen to underlie a host of ethical problems and dilemmas for either side to deal with in the area of corporate governance, as we shall see in a moment. Before we move on to the main ethical issues pertaining to shareholders, though, we need first to clarify the position of shareholders in relation to other stakeholders. Specifically, it is important to recognize that there are different models of corporate governance in different parts of the world.

DIFFERENT FRAMEWORKS OF CORPORATE GOVERNANCE GLOBALLY

In its broadest sense, corporate governance describes how the priorities of the corporation should be determined and, ultimately, who the company is there to serve. Different models of corporate governance operate in different countries, and so the role of shareholders varies quite significantly between different countries internationally (Aguilera and Jackson 2010). For many commentators there are two broad systems of corporate governance. On the one hand, there is the *Anglo-American* model of capitalism (Aguilera et al. 2006), which is primarily a market-based form of corporate governance. The Anglo-American model is predominantly evidenced in the UK and the US, as well as Australia, Canada, and Ireland. Crucially, the Anglo-American model has also started to influence many emerging economies, particularly in Latin America and Asia (Reed 2002).

On the other hand, there is a *continental European model*, sometimes also called 'Rhenish Capitalism' or 'social capitalism', given its focus on extensive state regulation of market outcomes (Albert 1991). This model is a more network- or relationship-based form of corporate governance, of which the European model is the oldest and most widely known. The continental European model is evident throughout most of the rest of Europe, most notably France, Italy, Germany, Spain, and Scandanavia as the largest economies on the continent. However, a similar approach, based on relationships (rather than markets), can also be found in many countries, in particular in the developing world, and also in Asia (Claessens and Fan 2002), which some refer to as a relationship-based approach to corporate governance (Clarke 2007). Figure 6.3 provides an overview of the key characteristics of the Anglo-American, continental European, and Asian models.

Figure 6.3 Key characteristics of corporate governance in Anglo-American, continental European, and Asian models

ANGLO-AMERICAN MODEL	CONTINENTAL EUROPEAN MODEL	ASIAN MODEL
Source of capital: Stock market	**Source of capital:** Banks and loans (not just the stock market)	**Source of capital:** Family-owned, bank-financed and state-owned
Focus: Shareholder value	**Focus:** Shareholder value, employee retention and non-profit goals	**Focus:** Shareholder value, employee retention, and non-profit goals
Executive remuneration: Based on stock market performance	**Executive remuneration:** Less directly performance-related	**Executive remuneration:** Less directly performance-related
Ethical concerns: Insider trading, manipulated accounting statements	**Ethical concerns:** Interests of large shareholders over individual investors	**Ethical concerns:** Reporting, transparency, and accountability underdeveloped
Agency: Employees typically have no say in the control of the firm	**Agency:** Supervisory board appointed by employees (stakeholder focus)	**Agency:** Relationship-based approach involving actors in supply chain

We can also consider differences and similarities from the perspective of corporate governance in different parts of the world. BRIC (Brazil, Russia, India, China) countries tend, in one way or another, to follow what is akin to a relationship-based approach, according to their specific economic and political heritage. In all of these countries, however, we see some degree of a shift towards more market-based mechanisms. An interesting example of how these different trends blend into each other can be found in the Indian approach to corporate governance (Sarkar and Sarkar 2000), which on the one hand is similar to the continental European model (as it is based on large block holdings of majority investors), but on the other hand also demonstrates elements characteristic of the Anglo-American approach (since many of these investors are actually companies and senior executives). This development is particularly encouraged by comparatively large numbers of foreign investors. Similar hybrid forms of governance can be found in many emerging economies, such as Brazil, where it is only in the last few decades that privatization has taken effect and companies have tried to attract more foreign capital and therefore adopted elements of the Anglo-American model (Rabelo and Vasconcelos 2002). The Russian case, furthermore, is interesting in particular for the phenomenon of owner-managers, often referred to as 'oligarchs', who amassed large parts of privatized former state-owned industries in the Boris Yeltsin era of the 1990s. With owners being managers at the same time, considerable conflicts of interest might obviously arise. The Chinese and South Korean contexts offer even more complexity, as ownership is highly concentrated in state-owned family companies, some private enterprises, and, in the South Korean context, in 'chaebols'—large, family-run industrial conglomerates.

Although it is useful to simplify corporate governance frameworks along these lines, it is important to take into account some important qualifications. First, as we have indicated, there are considerable pressures towards **convergence** in governance models, leading to hybrid models and shifts in the form if not always the substance of traditional governance arrangements (Yoshikawa and Rasheed 2009). For example, many of the more relationship-oriented forms of governance appear to be gradually taking on some elements of the Anglo-American model, but these are often resisted or combined with existing approaches, rather than simply replacing them. Especially since the global financial crisis of the late 2000s, the Anglo-American approach has been increasingly brought into question and it is now rarely considered (as it perhaps once was) the 'best model' of corporate governance (Aguilera and Jackson 2010).

Second, there is a considerable level of **heterogeneity**, as different countries characterized as using the same system may actually differ quite considerably. This goes not only for the diverse countries captured by the 'continental European' umbrella, but also, as Aguilera et al. (2006) show, for the ostensibly similar approaches evident in the UK and the US, which actually differ in a number of key respects. Focusing on a firm-level analysis, there may be a number of reasons as to why corporations do not conform to dominant governance logics.

Third, looking at the concept of corporate governance **deviance**, Aguilera, Judge, and Terjesen (2018) suggest that while the national governance context 'sets the stage' for defining normative governance expectations *outside* of the firm, entrepreneurial motivations emanating from *within* the firm see firms improvise their performance through risk-taking, proactive, and innovative behaviour. Aguilera et al.'s (2018) theory helps to articulate why firms underconform (adopt governance practices that fall short of the country's governance standards) or overconform (exceed prevailing governance norms) based on social and/or commercial motives, particularly in different country contexts.

THINK THEORY

Thinking of different corporate governance practices around the world in the context of moral relativism, are these just 'different' (i.e. reflecting different cultural and customary practices) or would you argue that some of them are actually more or less ethical?

Visit the online resources for a suggested response.

ETHICAL ISSUES IN CORPORATE GOVERNANCE

Corporate governance has been a business ethics topic high on the agenda of all major economies in recent years. Partly this has been the result of various scandals that have hit the headlines since the turn of the century. This started with the 'dot-com bubble', and the financial scandals that saw the spectacular bankruptcy of companies such as Enron, Tyco, and WorldCom in the US, and shocking revelations of financial irregularities at Parmalat in Italy and Ahold in the Netherlands, among others. Attention later turned to the collapse of many banks and financial institutions in the financial crisis of 2008 and its aftermath. A swathe of governance scandals in Asia in the 2010s, including at Olympus, Tokyo Electric Power, and Daiwo Paper in Japan, also led to suggestions of 'seemingly free-wheeling behavior—and disregard for corporate governance … among top management at some of Japan's leading companies' (Tabuchi 2011). More recently, in 2016 and 2017 we have witnessed the calling out of corporations who have offshored profits into tax havens,[2] leading to calls for greater transparency into the financial activities of multinational corporations and how they are controlled. Such phenomena have resulted in unprecedented interest in the ethical dimensions of corporate governance. In the following sections, we will examine the main issues arising here, focusing specifically on those that primarily affect shareholders, namely: executive accountability and control, executive remuneration, ethical aspects of mergers and acquisitions, and diversity on corporate boards.

EXECUTIVE ACCOUNTABILITY AND CONTROL

Looking at corporate governance, there are certain core elements that need to be present in order for the principal–agent relationship to be managed effectively. The most important element is a separate body of people that supervises and controls management on behalf of principals—namely, a board of directors. It is the board to which the chief executive officer is accountable for their performance, and the board that will appoint the CEO and determine their salary. Unless the board has effective oversight and control of senior executives, the principal–agent relationship collapses. Effective corporate governance therefore relies on executive accountability.

Executive accountability The systems and processes through which senior executives can be held responsible for the performance of the firm by shareholders and other stakeholders, typically via the board of directors.

In practice, the drive for executive accountability and control tends to result in a dual structure of the board of a publicly owned corporation. On the one hand, there are *executive directors* who are actually responsible for running the corporation as well as supposedly providing a link between managers and shareholders. On the other, there are *non-executive directors* who are supposed to ensure that the corporation is being run in the interests of principals, usually shareholders.

The alternative global governance frameworks have important differences in the way that this board is structured and composed. There are basically two extremes. In the *Anglo-American* and *Asian* models, there is usually a single-tier board that comprises both executive and non-executive directors. In *continental Europe*, however, a two-tier board is more common. The upper tier is composed of non-executive directors and the lower tier of executive directors. The upper tier, often also called a *supervisory board*, effectively oversees the lower tier, which is more concerned with the day-to-day running of the company and includes representatives of stakeholders other than just shareholders, including banks and employees. Perhaps unsurprisingly, therefore, there is considerable variability across countries in the extent to which executives are actually held accountable for the performance of their firms, for example by being fired for poor returns (Crossland and Chen 2013).

Regardless of the structure of the board, the central ethical issue here is clearly the independence of the supervisory, non-executive board members. They will only be able to reasonably act in the principal's interest if they have no directly conflicting interests. In order to achieve this, a number of points are important (see Nader 1984; Boyd 1996):

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- Non-executive directors should be largely drawn from outside the corporation.
- They should not have a personal financial interest in the corporation other than the interests of shareholders. This includes the fact that the remuneration for the non-executive director role must not significantly exceed a reasonable compensation for time and other expenses.
- They should be appointed for a limited period in order to prevent them from getting too close to the company.
- They should be competent to judge the business of the company. This would require, and to some degree allow, a limited number of insiders, such as former executives or even works council members (such as in certain parts of Europe).
- They should have sufficient resources to get information or commission research into the corporation.
- They should be appointed independently. This would be either by the shareholders directly in the annual general meeting, or through appointment by the supervisory board.

A further element of supervision comes from an independent auditor who audits the work of the executive board—normally the main aspect of their role—and also of the non-executive board. We will discuss the role of auditors and the ethical issues involved a little later.

Despite the guidelines above, the independence of non-executive directors remains a delicate issue. Often they belong to the same peer group as executive directors, or are themselves in executive roles elsewhere, or have been in such roles in the past. This means that a completely neutral and independent approach will always be quite difficult to achieve (Gordon 2002).

EXECUTIVE REMUNERATION

The financial crisis of the late 2000s brought the issue of executive pay to centre stage in an unprecedented fashion, as executives of bankrupt or failing companies continued to earn millions in salaries and billions in bonuses. 'Shameful' and 'the height of irresponsibility' were US President Obama's comments on what continued to be common practice, not only in the US, but in many other countries across the globe. Public concern about excessive executive salaries has fuelled a rise in online attention to the issue, including a slew of activist websites (e.g. UK-based High Pay Centre), responses in legislation (e.g. the ratio between CEO compensation and the median salary of employees published through the US Dodd–Frank Act requirements), and advisory consultants (e.g. Salary.com in the US and Canada) that seek to promote transparency about current pay levels.

The general trend towards ever-increasing executive salaries has been driven by the dominance of the shareholder value ideology. However, the key element here actually derives from an attempt to address the core of the agency problem: in order to align the interests of both parties, the perfect solution appeared to be to pay executives in the same 'currency' that matters to shareholders, namely dividends and rises in share price. The logical conclusion then is to pay executives in shares—or more commonly, in options that allow executives to buy shares on a future date. In order to make the incentives work, it would not be sufficient to pay them with just a few shares or options but to a degree that substantially impacts on their wealth. As a consequence, the US in particular has led the way in rewarding senior managers with massive stock option deals. This approach of performance-related pay has especially taken hold in the finance industry, resulting in high salaries and bonuses even for mid-level executives in financial services and banking. In 2016 the average CEO salary was $15.6 million; almost 270 times more than the US average salary. Indeed, in the UK, 4 January is labelled as 'Fat Cat Wednesday'; the day when a CEO has already earned more than an average worker earns in an entire year. Meanwhile, the link between executive remuneration and stock market performance has always been somewhat tenuous (Walsh 2008).

Examples such as these unveil many of the ethical problems with executive pay in firm–shareholder relations:

- First, there is the issue of designing appropriate *performance-related pay* in a world of reinvigorated shareholder value (Koslowski 2000). In order to tackle the problem of divergent interests, most executive remuneration packages now contain a significant number of share options to align shareholder and manager interests, but this has resulted in rocketing salary levels and uncertain effects on share prices.
- Secondly, these shifts in remuneration show the influence of *globalization* on executive pay. Since the market for executive talent is a global one, increases in one country tend to drive up pay internationally.
- Thirdly, the *influence of the board* appears to be somewhat limited and often fails to reflect shareholder (or other stakeholder) interests. Why would shareholders want to reward a CEO who had overseen a period of poor performance?

Such problems show few, if any, signs of diminishing. In Europe, the EU Commission began attempts in the mid-2010s to strengthen shareholder rights with regard to executive compensation, while Switzerland even put the topic to an unsuccessful public referendum in 2013

(Dijkhuizen 2014). In the US, reforms to CEO remuneration and increased transparency over CEO-staff salary ratios are being pushed by the Dodd-Frank Wall Street Reform of 2010 and the UK may look to make a similar legislative move. What drives reform here is, of course, not so much the public feeling sorry for shareholders, but the fact that the pay differentials between those at the top and those at the bottom appear to be so inequitable. We shall cover this issue again in Chapter 7 when we address the question of fair pay for employees.

BOARD DIVERSITY

A substantial body of literature has looked at the attributes of successful corporate boards and how these attributes translate to corporate performance (Payne, Benson, and Finegold 2009). Such research argues that companies should work towards board diversity: a broad range of skills, backgrounds, age, gender, ethnicity, and sexual orientation represented on the board of directors. Paying attention to such recommendations can reap dividends for contemporary businesses, with research suggesting that increased female board representation can positively influence a firm's financial performance and corporate governance practices due to their knowledge, experience, and values (Post and Byron 2015), leading to improved CSR ratings (Bear, Rahman, and Post 2010). However, in practice, the representation of women on boards remains low in the vast majority of corporate boardrooms. A recent UK study found that just 22% of the companies surveyed had a woman on their board (Turner 2017).[3] Ethnicity figures paint a similarly dismal picture. In 2017, Fortune reported that in the US, just 22% of new board director appointees were African-American, Hispanic or Latino, or Asian-American.[4]

Board diversity A broad range of skills, backgrounds, age, gender, ethnicity, and sexual orientation represented on the board of directors.

While there have been important legislative forays into making boardrooms more diverse in Norway and Spain, most countries prefer to mandate boardroom diversity on a more voluntary basis. This affords firms with the freedom to appoint boards that are in fitting with their own values and aspirations, leading to questions about the fairness of recruitment and selection processes. We will return to this theme in Chapter 7 when we discuss workplace discrimination. Yet the future is not all gloomy. As Dhir (2015) illustrates, Norway's introduction of a quota-based approach to achieving gender balance in corporate boardrooms has spurred substantive corporate governance reform. With women holding over a third of seats on Norwegian stock index companies, such initiatives, which were deemed by many to be controversial, are opening up dialogues around effective methods of corporate governance in the global marketplace. The extent to which these developments create positive implications for other areas of diversity is yet to be seen.

ETHICAL ASPECTS OF MERGERS AND ACQUISITIONS

From a societal point of view, mergers and acquisitions might be encouraged if they involve the transfer of assets to an owner who will use them more productively and thereby create more wealth. The alternative is to leave the assets in the hands of a less-effective management, with higher costs, less innovation, and other costs to society. However, there are a number of

ethical issues that might arise, as many examples of unsuccessful mergers demonstrate. The central source of ethical concern in this context is that managers may pursue interests that are not congruent with the shareholders' interests. A study by KPMG of 700 mergers found that only 17% created real value for shareholders, while more than half actually destroyed value (Surowiecki 2008). As a result of such failures, some companies have reversed their decisions and have begun demerging. Consider Hewlett-Packard, which after having spent more than $60 billion in the previous decade on acquisitions, announced in 2014 that it would be splitting its business. More recently, L'Oréal sold UK beauty brand The Body Shop to Brazilian cosmetics company Natura in 2017 in the wake of increasing competition in the market for ethical beauty and cosmetics. The Body Shop takeover shocked many at the time because of the seeming incompatibility between the company's ethical focus and L'Oréal's more mainstream credentials, and recent challenges may suggest that these early critics may prove to have been correct. Basically, the conflict boils down to a desire for power and prestige among senior executives in driving mergers on the one hand, and the interests of shareholders in driving profit and share price on the other.

There is, in particular, a wealth of discussion in the American business ethics literature on this issue, mainly since the US business system strongly encourages these types of transactions—more so than is the case in tightly regulated Europe, or in BRIC countries with more narrowly held stock ownership. However, with an increasing deterritorialization of financial markets, these practices have also become more common across the globe in recent years, as the example of mergers of French, German, or Swedish companies in the telecommunication and utility industries illustrates. In the following, we will look at the main issues that have arisen or are likely to arise.

Next to 'normal' mergers, there are particular ethical problems involved in so-called *hostile takeovers*. Here, an investor (or a group of investors) intends to purchase a majority stake in a corporation (often secretly) against the wishes of its board. Without going into a detailed philosophical debate, there are basically two lines of argument here. On the one side, it could be argued that hostile takeovers are ultimately possible only because shareholders want to sell their stock; otherwise they would keep it. On the other side, an ethical concern may arise with the remaining shareholders that do not want to sell. If the company is taken over by someone who has different ideas about the corporation—for instance, an 'asset stripper' that wants to split the company and sell off certain parts—a hostile takeover might interfere quite significantly with the property rights of those remaining shareholders.

Even relatively friendly acquisitions can create ethical challenges when they are predicated on realizing shareholder value at the expense of other stakeholders. For instance, Jack Welch, the well-known former CEO of General Electric (GE), acquired his nickname 'Neutron Jack' because he turned GE into one of the best-performing conglomerates on Wall Street through the acquisition of all sorts of corporations, and significantly *restructuring* and *downsizing* them immediately after takeover. The buildings and assets remained; only the people had to leave—similar to the effect of a neutron bomb. Very often, acquisitions only target the profitable parts of the bought-up corporation, while at the same time the other parts will be liquidated. Sometimes these acquisitions even focus only on the brand value or certain patents and technologies of the bought-up firm, with the consequence that other stakeholder interests, such as those of employees or local communities, are seriously disregarded.

THE ROLE OF FINANCIAL MARKETS AND INSIDER TRADING

There has been a remarkable silence in the literature on financial markets with regard to ethical issues (Rudolph 1999). A simple justification for this would be that, as long as the rules of the market are set fairly and everyone plays according to these rules, no ethical dilemma is to be expected. Yet behind this argument is the assumption of a perfect market, and in particular the assumption that, ultimately, all publicly available information about the company is reflected by the stock price. However, we all know that this simple rationale of 'the stock market never lies' is only part of the truth. Sometimes, the alleged 'information efficiency' of stock markets is quite flawed, as the following issues show.

Speculative 'faith stocks'

An often-discussed problem is the speculative nature of share prices. This not only became evident in the financial crisis of the late 2000s, but also during one of its predecessors, the burst of the 'dot-com' bubble in the late 1990s. Start-ups that had not made a single cent in profit but were valued at billions of dollars on the Nasdaq in New York or the Neuer Markt in Frankfurt then took this speculative element to an extreme. These stocks were not so much built on solidly calculated profit expectations, but were more like 'faith stocks' (Gordon 2002), built on little more than blind faith. Even a company such as Amazon.com, which is one of the successful survivors of that crisis, needed more than seven years to make even a dollar in profit. Even now, after 20 years in business, it still does not consistently generate profits and regularly reports quarterly losses. Yet its share price rose from $34 to $1485 from 2007 to 2018, providing significant returns to its investors.

In some sense, the financial crisis of the late 2000s had similar roots. The complex structured finance products that mortgage lenders and other financial institutions traded to manage the risk of sub-prime mortgages were all based on 'faith' that the real estate market would continue to rise. As long as this faith held, most actors involved thrived. When the downturn set in, however, it not only turned out that the optimism was misplaced, but also that the products were way too complex for the managers involved to foresee the likely consequences.

One problem here is that many pensioners, whose funds had invested in these bonds, lost large parts of their income. The ethical issue clearly lies in the fact that, while stock prices always contain an element of speculation, stock markets do not always fully reveal the amount of uncertainty. This might be somewhat trivial for brokers or other stock-market professionals; however, with large institutional investors investing other people's money in these stocks, the fact that these bonds may be based entirely on speculation can be said to be close to an abuse of trust. This also questions the role of analysts and accountants (see section 'The role of financial professionals and market intermediaries') who, among others, are responsible for ensuring *informed* transactions on the stock market.

High-frequency trading

With the rise of electronic trading and an ever-increasing speed of data processing, a new area of ethical concern has arisen around what is often referred to as 'high-frequency trading' (HFT) (Lewis 2014). Brokers using HFT buy financial assets and only hold them for microseconds, to benefit from minimal changes in the value of the assets, before selling them. There are two