A pragmatist case for thoughtfulness and experimentation in corporate governance

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Abstract

Despite interminable debate, ethical perspectives have sought to stem the abuse of corporate power by focusing on the split between utility-focused attention to shareholder value, including the 'enlightened' kind, and duty-focused imperatives in stakeholder theory. Through thought experiments, this chapter builds a case for a different approach. Ethics scholars including Brandt (1959) and Frankena (1963) highlight contrasting approaches to both utility and duty, separating formation of general rules from examination of individual acts. Act-based ethics points us toward the pragmatism of James (1907/1955) and Dewey (1930) and 'what works.' In the context of boards that means connecting duty and consequences and encouraging a fullness of thought: board-level thoughtfulness. This approach has echoes of Werhane's (2002, 2008) concept of moral imagination and Rorty's (2006) more radical call to reject recipes and seek new solutions.

Key Words: ethics, act, rule, compliance, experimentation, imagination, thoughtfulness

INTRODUCTION

In much scholarship on corporate governance, the 'agency problem' of excessive executive pay or management shirking was viewed primarily as an economic issue to be addressed by market mechanisms, such as aligning incentives with shareholder interests. Fiduciary duties provide a supporting argument, with law as a proxy for ethics. Shareholder primacy based on arguments over residual risk has dominated the regulatory agenda, leading to legal mechanisms to increase shareholder power (Bebchuk, 2005; Fama & Jensen, 1983). However, by focusing on the work of boards, the UK Cadbury Code (1992) brought attention to the ethical dimension of corporate governance, with effects well beyond its home jurisdiction.

Codifying governance has brought benefits in the many countries that have taken this approach. It has reshaped the work of boards and improved their accountability. Directors are now better prepared, work harder, and exhibit greater independence from management. But problems of corporate governance persist and in some senses have intensified, even as responses to ethical issues have institutionalized (Nordberg, 2020b).

The work of boards is conducted in groups whose dynamics involve the separate and sometimes contradictory ethical understandings of the individual directors. Each director might not be able to articulate an ethical stance philosophically. Nor should we outsiders – observers, researchers, regulators, legislators, or members of public – expect that. After all philosophers have been unable to resolve the questions of ethics in hundreds of years – perhaps millennia – of debate.

We can, however, present of picture of the complications in the task, which will point to ways of understanding the issues and researching the practice of board decision-making. This chapter also raises warning flags about attempts to regulate or codify these practices in absence of clear evidence. Philosophical pragmatism, which places normative weight on experience and encourages experimentation, points to a blended understanding of how ethics can affect the workings of boards, and how board practices can affect the understanding of what constitutes an ethical decision.

Let's start with a short course on ethics, sketching the age-old disjunction between two ethical systems based respectively on notions of duty and consequences, reflecting those against the questions of shareholder value and stakeholder rights. Next, and to ground the rest of the discussion, we will look at three hypothetical decisions, two in public companies and one in a privately owned business. Following that, we return to ethical theory, paying attention to two aspects of it somewhat overlooked in management studies and corporate governance: recent theorizing from experimental evidence to notions of moral psychology and the somewhat overlooked distinction between act- and rule-based approaches. After a brief introduction to pragmatism, we return to the three cases to answer the question they pose in common: How should the board decide? The chapter concludes with a discussion of opportunities for research into practice, warnings about the pitfalls of governing the work of boards, and a plea for thoughtfulness and greater tolerance of attempts to navigate past the mines that litter this field.

CORPORATE GOVERNANCE AND ETHICS (NUTSHELL VERSION)

The battlefield of ethics in management – and by extension in corporate governance – often seems to be occupied by a noisy conflict over the purpose of companies and the normative implications of each side. Should companies strive to achieve shareholder value? Or should they serve a wider range of stakeholders: suppliers, customers, employees, the community, the environment? Advocates of shareholder value sometimes argue that this economic principle is prescribed in law. Others dispute such legal obligation and arguing the

case for a moral obligation to others (Hansmann & Kraakman, 2001; Mukwiri, 2013; Stout, 2011). An attempt to bridge that gap has come in the discussion of what is often called 'shared value' or 'enlightened shareholder value,' which seeks to theorize, and show empirically, that paying attention to all stakeholders pays off for shareholders in the long run (Keay, 2013; Porter & Kramer, 2011).

Serving shareholders is often seen as requiring decisions based on a calculation of utility, the net present value of future cashflows, for example. Serving others is often depicted as the duty companies owe to those affected. Couched in this way, the ethics of corporate governance and boards is the much rehearsed debate between utilitarian ethics (the greatest good for the greatest number – of shareholders) versus the duty owed to all those affected by a company's operations (Nordberg, 2008a).

Utilitarianism, perhaps the dominant strain of consequentialist ethics, holds that we should act in ways the increase general welfare (happiness, in Jeremy Bentham's 18th century account, 1789/1904). Assessing welfare, happiness, or even the more economics-oriented utility is not straightforward, however. The philosopher Bernard Williams wrote that discussion of consequentialist ethics had generally collapsed into an economic calculation of utility, and that there are 'notorious problems in comparing utilities' (Smart & Williams, 1973, p. 80). Nor is it obvious whether individuals' self-interest or a collective interest should govern such decisions. John Stuart Mill (1863/1991) qualified Bentham's ethical-egoist approach on these points. In doing so, did he undermine the theory fatally?

The duty to treat other stakeholders fairly calls to mind a very different ethical stance, that of Immanuel Kant (1785/1964) and his formulations of the categorical imperative to act always in a way that you would wish to be a universal law, and never to use other human beings[1] solely as means to an end. This stance underpins the political theory of justice and fairness influentially articulated by John Rawls (1999), which envisages a social contract constructed behind a 'veil of ignorance.' In this position, no member of society knows what social rank or personal endowments they themselves hold. Behind that veil, rational people might well accept unequal conditions, but they would also choose not to do anything that would disadvantage the weakest. Rawls's stance has influenced much political thinking, including how such justice applies at firm level and stakeholder relations (Fia & Sacconi, 2019).

Philosophers have long battled over which of these approaches – consequentialist or deontological (duty-based) – is what we mean when we speak of ethics or morality and thus what decisions we should make. Should we act to promote welfare by assessing the

consequences of our actions? Or should we decide according to some predetermined, *a priori* imperative, whether derived from some transcendental or religious instruction or, as Kant attempted, through an appeal to reason alone? While the debate has produced many illustrations about how the two cannot be harmonized, are there circumstances in which they might be aligned and bring the decision debate to a more rapid close? We also face another choice: Should we decide what is a right, good, or rational course of action based on a general rule, or should we examine each case on its merits?

Management thinkers have followed this line of reasoning, adding other context-specific dimensions. One is that of the management scholar John Hendry, who argues for a more nuanced stance. Corporations and boards face a 'bimoral' world, with social obligations set in contrast to market processes based on self-interest. Moreover, there are 'no clear rules determining which should be applied in any particular circumstances' (Hendry, 2004, p. 168). For Hendry, the morality of self-interest is not hedonism; it recognizes that firms and boards work within teams and networks. They are collaborative, requiring more subtle assessment of consequences alongside obligations to others.

Another incorporates the two facets of the work of boards of directors: the need to oversee management and prevent damage (control) and the need to support management's effort to create value, for shareholders and others (service). Law, regulation, and codes often focus on the former. However, the business ethicist Patricia Werhane (2002, 2008) has called for opening decision processes to 'moral imagination' the ability to discover and assess ways of working not bound by rules or mental models. Moral imagination 'helps one to disengage from a particular process, evaluate that and the mindsets which it incorporates, and think more creatively within the constraints of what is morally possible' (2002, p. 34).

Her work prompted the pragmatist philosopher Richard Rorty to urge a more radical approach. If we refrain from seeing Kant (duty) and Mill (utility) as opponents in ethical debate, we can see what they shared: Each extended moral insights from the past to contemporary issues – Kant coming to terms with Newtonian science, Mill seeing value in the emancipation of women (Rorty, 2006). Imagination recognizes value in experiments, in reasoning and action. If one idea does not work, experimentation is needed, not rules.

THREE CASES

To examine these issues in the context of board decisions, let's keep in mind three practical examples, fictional cases that might be real. They will help us ground the abstract and often esoteric arguments about ethical theory in issues familiar to boards of directors.

Case 1: End Run

American football involves a tactic called the end run. A player carrying the ball attempts to outflank the defense by throwing opposing players off balance by a feint, coordinated with several teammates, and running around the far end of the defensive line. This approach has become a metaphor for 'evasive or diversionary action' (see thefreedictionary.com).

Let's imagine a company where problems are developing in its aggressive strategy of expansion. It relies on first, second, and even third-order derivative contracts not as hedges, but instead to leverage its underlying physical commodity trading business. As losses mount, it sets up a bevy of offshore, off-balance-sheet companies to house the failing contracts. They are legally independent entities, not subsidiaries, located in jurisdictions with opaque corporate reporting. The company calls itself 'End Run' in honor of its gridiron-like business model.

The board, duly constituted under the laws of the land, follows industry regulations and listing rules of the stock exchange. According to accounting standards, these actions are fine, as the auditors attest. And yet the board knows that bad contracts are being parked externally to gloss over the shortcomings of End Run's business model and its management's failings. Fixing it in a public way will crash the company's share price. Quietly bringing those contracts back on the balance sheet would have the same effect over time and intensify criticism of the company's lack of transparency. Management presents a route that would allow it to work out some of the offshore losses. Those that cannot be resolved could simply disappear by letting those offshore vehicles fall into default. Both elements, though, are based on plausible but worrying assumptions. Those entities are external, after all, and thus in economic and accounting terms externalities, somebody else's problem. Their obligations need not be met, in law or regulation, by End Run itself, provided the board agrees. How should the board decide?

That the name 'End Run' chimes with Enron is coincidental. Enron's 2001 collapse precipitated global reform of corporate governance codes, regulations and laws, an overhaul of the audit profession, and thorough revision of accounting principles around the world. Many countries thus yielded sovereignty to an unelected panel of experts. (Healy & Palepu, 2003; Nordberg, 2008b.)

Case 2: Spleen FC

Let's imagine a venerable European professional sports organization, Spleen Football Club, owned, personally, on a 50-50 basis, by two individuals. They are business partners in a string of sport-related investments around the world. Some are stunningly profitable; others –

like bets on a football match – are speculative, more likely to fail than win. That's part of the fun. As with all equity investments involving limited liability companies, it is a one-sided bet. Failure means losing the funds invested; success brings an unlimited upside. The effect can be multiplied by loading all portfolio companies with debt, further limiting the downside risk.

One day the pair fall out over personal disagreements unrelated to Spleen FC, which becomes a vehicle through which they can punish each other. They refuse to agree on investment in new players or on improvements to the grounds to boost matchday revenue. As the squabble continues, the club opens a new season by sinking to the bottom of the table. Threat of relegation to a lower league creates an immediate, even visceral risk that players under contract will demand transfers, creating a downward spiral from which it will be difficult to recover for many years. The five-person board, made up of the two owners and three non-shareholding executive directors, receives an inquiry. Would they like to sell the club, its real estate, players, naming rights, brand, replica shirts contracts – lock, stock, and barrel – before it's too late? How should the board decide?

That Spleen FC seems, by gut instinct, related to Liverpool Football Club in 2010 is coincidental. In the case of Liverpool FC, the board voted to sell, three-to-two with the owners in dissent. The board rejected what *in their certain knowledge* shareholders *valued*, favoring instead what the players and fans wanted (Nordberg, 2012). Liverpool FC recovered, remained in the English Premier League, and went on before too long to win in the league, and win in the European Champions League, despite facing ever-intensifying competition at home and in Europe.

Case 3: Petroleum Beyond

Let's imagine an oil and gas exploration and development company, Giant Petroleum, with a 150-year track record of success at identifying fields of hydrocarbons that powered the second wave of the industrial revolution, the age of the automobile and aviation, modernization of railroads, not to mention tourism and hospitality. At the turn of the 21st century, however, its visionary chief executive realizes the game is up, not immediately but within a future he can foresee. He wins board approval to re-name the company to Petroleum Beyond. It is still in the petroleum business but moving beyond it.

A few years later, a government-sponsored research report provides climatological and, importantly, economic justification for the new strategy. There is a problem, however. To justify the economic argument, the report's author argues that distant costs have almost the same value as current costs. It is, he says, an 'ethical decision.' It is also a violation of what every economics student learns about discounting future cash flows. Using a normal discount

rate – say, eight percent, not half a percent – investing in anything other than petroleum looks foolish.

Moreover, every business strategist worth his MBA is advising the hedge funds now mounting a proxy challenge. Competitive advantage, they say, lies in scale economies, cost leadership. But not only. Advantage is sustained, they argue, only by possessing a base of resources that are valuable, rare, difficult to imitate, controlled by the organization, and that lack viable substitutes. Petroleum Beyond is replete with intangible resources in many patents and the skills and knowledge of its workforce, as well as tangible assets underground. Even if solar and wind power are the (distant) future for humanity, what can Petroleum Beyond offer? Wouldn't it be better – more efficient – for stock markets to allocate funds to new technologies, as they always have? Isn't it better to use cash flow from a re-re-named Giant Petroleum to maximize dividends and accelerate that change, as some scholars claim (Edmans, Enriques, & Thomsen, 2021)? How should the board decide?

That the name 'Petroleum Beyond' differs only in word order from the marketing slogan of BP in the early years of the 21st century is coincidental. BP dropped the 'beyond petroleum' strapline in the years following Sir John (now Lord) Browne's retirement. (He stepped down, under investor pressure, for an unrelated indiscretion.) BP then concentrated on doing what it had always done best. Then, in 2010, one of its major offshore oil drilling operations suffered a catastrophic failure, seemingly due to poor maintenance and operating protocols. The 'Deepwater Horizon' debacle saw Browne's successor lose his job and company face lawsuits and fines that seemed for a time to present an existential threat (Lin-Hi & Blumberg, 2011). Meanwhile, acceleration of climate change, compared to those used in the UK report on the economics of climate science (Stern, 2006), suggests that the distant future Lord Stern foresaw wasn't quite so distant.

HOW SHOULD A BOARD DECIDE?

The question is both processual (*how*) and normative (*should*): – not how or why 'does' or 'did' one (or another) board decide? For the sake of clarity, let's use the terminology of the British-Australian philosopher J.C.C. Smart to discuss some troublesome words in ethical theory across three dimensions: the motivation of decision-maker, the outcomes of the decision, and the method of cognition used in reaching it. In his contribution to a debate with Bernard Williams, Smart suggests we use the terms in this way: *Good* and *bad* are attributes of agents, signifying the quality of their motivations; *right* and *wrong* are evaluations of outcomes; *rational* and *irrational* describe the likelihood that a decision process will yield the

best result (Smart & Williams, 1973). These definitions in themselves present a bias toward a consequentialist approach, which we will need to bear in mind. But using them has the advantage of avoiding unintentional conflation or confusion of the concepts themselves. A related problem is that, under the irrational, Smart subsumes the instinctive and intuitional, a category of decision process that features prominently in the work of boards. Let's keep that in mind, too, as we look at three other facets of ethics and boards.

Group Decisions

First, most writing on ethics concerns the decisions of an individual actor, a human agent making choices with a moral dimension. Boards are not individual actors, however; nor are they conventional workgroups. As Forbes and Milliken (1999) note, boards are groups made up of elites, often outsiders with primary affiliations elsewhere. They meet only episodically to examine multifaceted problems. And they are large compared with many workgroups, typically a dozen or more people, adding process complexity to the complexity of substance. Moreover, board decisions are often made by consensus rather than votes. Individuals accept collective responsibility for the decision. Decision-making processes involve considerable persuasion (Leblanc & Gillies, 2005). How then should we adapt process issues in ethics to the setting of corporate boards?

Moral Psychology

Second, development of ways to monitor brain activity has opened a new line of inquiry in how ethics might be involved in decision-making. Experimental studies using fMRI scans suggest that people respond to ethical dilemmas to two quite different ways: First is a reaction to things the subject finds repugnant. It is very quick and quite strong, appearing in areas of the brain associated with emotional reactions. In the second, the subject activates areas of the brain associated with calculative functions, which are then active for an extended period. These two responses suggest a biological, even evolutionary development that could form different bases of advantage for survival (Rueda, 2021). Popular accounts of such scientific work link the findings to political orientation (Haidt, 2012) and understandings of the tribal behavior of groups (Greene, 2014). It has parallels in the work on instinctive responses and computational heuristics that Kahneman (2011) calls System 1 and 2 thinking.

Act- and Rule-based Ethics

The third aspect concerns a question raised earlier: Do we decide moral issues based a general rule or by considering the conditions affecting a specific case? This line of questioning features in the writings of mainstream ethicists, including Richard Brandt (1959) and William Frankena (1963). The eclectic French philosopher Michel Foucault sketches a

similar distinction in defining how he uses the terms ethics and morality. Morality, he writes, is 'a set of values and rules of action that are recommended to individuals through the intermediary,' whereas the 'ethical subject' decides on a 'mode of being,' which 'requires him [sic] to act upon himself, monitor, test, improve' (Foucault, 1990, p. 28). His approach thus separates rule-based decisions and act-based introspection, leaving open whether the system behind is deontological or consequential. Such approaches appear in both utilitarian and deontological theorizing. While rule-deontology seeks guidance from maxim like 'telling lies is improper because it devalues the person lied to,' act-deontological choices involve asking, 'Will lying to this person devalue her?' Rule-utilitarians would ask, 'Does telling lies harm human welfare more than telling the truth?', while act-utilitarians would ask, 'Is telling this lie, to this person, on this occasion more likely to cause benefit or harm?' Smart contends that rule-utilitarian constructions collapse into act-utilitarian ones with only a little prodding (Smart & Williams, 1973).

This discussion helps clarify our central question. How should a board decide: a) deontologically, based on a rule promulgated by a legitimate authority; or a rule developed for a set of circumstances but responding to a principle unrelated to benefits? Should it decide b) consequentially, based on a general observation of the effects of a mechanism across a wide sample of organizations, or by a benefit analysis based on the circumstances of the immediate issue to be decided? All four approaches have strong grounding in ethical theory.

PRAGMATISM AND THE BOARDROOM

Boards face such questions regularly, though in less abstract forms. There is a vacancy for a director. Do we look for a woman for the sake of improving gender diversity and social justice, or for the sake of the wider perspective women bring to discussion of consumer markets? (Rule-deontological and rule-utilitarian approaches, respectively.) Notwithstanding the need (duty- or utility-based) for greater gender diversity, do we hire a man to fill the vacancy because this man is a prominent exponent of our company's values, or because this man has specialist skills that can help us understand a specific legal issue the company is facing in its business expansion in the Middle East? (Act-deontological and act-utilitarian approaches, respectively.) We could also construct scenarios in the other directions: act- versus rule-utilitarian; act- versus rule-deontological; act-deontological versus rule-utilitarian; rule-deontological versus act-utilitarian. More complex combinations exist if there are more than two candidates, or more than one vacancy.

That complexity complexifies further when there is a possibility that the rationality of the decision is opposed not by the easily neglected irrationality of Smart's formulation of ethical dimensions, but instead by a moral-psychological view that points to a deeply embedded and perhaps biological propensity of individuals to view certain actions in non- or differently cognitive ways. And it complexifies further still when it is a board making the decision, that is, a large group of differently motivated, differently cognitively oriented individuals who meet infrequently enough that they do not come to share a broad framing of ethics – deontological or consequential. For decades boards have worked to prevent such groupthink by seeking out independent thinkers (a rule-utilitarian response), or at least people who meet the criteria for independence in a code of corporate governance (rule-deontological). Moreover, their work requires decisions, not further argument over theories that philosophers have been unable to resolve for centuries if not millennia. It should not be surprising, therefore, if in practice boards act pragmatically.

Pragmatism, as a philosophical stance, is wary of grand systems, of claims to certainty and *Truth*. Arising in the late 19th century under the influence of Hegel's historicism and Darwin's evidence of evolutionary change, its founders – C.S. Peirce, William James and John Dewey – regarded many of the questions philosophers ask as impossible to answer. What matters, ontologically, epistemologically and ethically, is what works (James, 1907/1955). Grounded in empiricism, pragmatism is nonetheless open to ambiguity and the need for interpretation, and skeptical of anything absolute, foundational, or transcendental. Attacked by both conservative and radical system-makers, this school of thought went into retreat in the face of horrors of the Nazi Germany. It resuscitated in the post-war period, however, as a hopeful alternative to existentialism, structuralism and much postmodern thought (West, 1989).

A pragmatist view of ethics suggests that decisions should be based on the best possible information but in recognition that information would be incomplete. Context matters. What might be right (in Smart's sense) now, might not have been right in the past and would not necessarily be right in the future. This line of thinking opens it to the charge of relativism, and thus no better than the nihilism many traditional ethicists saw in postmodern thinking. The late 20th Century pragmatist Richard Rorty, who did much to reinvigorate the work of Dewey and saw much value in postmodernism, often described himself as a relativist. In a book published late in his career, however, he retreated from the label: 'Insofar as 'postmodern' philosophical thinking is identified with mindless and stupid relativism … then I have no use for such thinking,' he writes (Rorty, 1999, p. 276). In that work, he preferred

the label 'philosophical pluralism,' a term that embraces Dewey's view of the value of working from experience, that is, how individuals deal with their encounters with the world, and the importance of experimentation as a route forward (Dewey, 1930).[2] And though both Dewey and Rorty are skeptical about the inevitability of human progress, they are far from nihilistic. Rorty's book bears the title *Philosophy and Social Hope*.

This matters for board decision-making in several ways. First, boards often act, and say they act, pragmatically. Their directors may not subscribe to this branch of philosophy; they may even issue vision and mission statements that speak of something transcendental. But they generally appreciate the need to fit strategy to the business environment, in the knowledge (or at least with the conviction) that the business environment is constantly shifting. What is right, in Smart's sense, is what works, in the sense of James.

Second, and at least in certain circumstances, boards experiment. Klarner, Probst, and Useem (2020) show how directors with specialist knowledge engage deeply with product innovation, spurring their boards into similar activities. Zona, Zattoni, and Minichilli (2013) show how board engagement in innovation is contingent on firm size, while Filatotchev, Toms, and Wright (2006) show how firms alter their governance arrangements and dynamics of strategic decision-making based on their life-cycle phase. The latter two studies argue from a standpoint more structural-deterministic than pragmatic, yet both see decisions arising contextually.

Third, those who compose codes of corporate governance have from the outset been alert to the danger of excessive prescription. Many followed the lead of the UK Corporate Governance Code of creating options for flexibility through the comply-or-explain mechanism.

In drafting the original 1992 code, Sir Adrian Cadbury was aware of the problem, urging flexibility even as he specified structural changes in how boards work. Between the first draft and the final code, he softened its language. The phrase 'comply with the code or explain why not' became 'state whether they are complying with the Code and to give reasons for any areas of non-compliance' (Cadbury, 1992, paragraph 1.3). In reviewing his consultation notes, Cadbury jumped on a suggestion from the auditors at Arthur Anderson, writing 'experimentation' in the white space on that submission. Elsewhere he made the notation: 'More emphasis on behaviour needed, less on structure?' These signaled his concern that codifying governance might damage the ethos of corporate boards (Nordberg, 2020b).

In the public consultation about the 2010 update of the code, many companies protested that investor practices had turned governance into compliance, fostering a 'tick-box'

mentality. Sir Christopher Hogg, chair of the UK Financial Reporting Council, responded by declaring that the code was 'not a rigid set of rules.' Building on that, Hogg, a former chief executive of a major UK listed company and former chair of another, urged companies to avoid the 'fungus' of 'boiler-plate' language in drafting their governance reports (Nordberg, 2020b).

Those warnings are warnings that institutionalizing code provisions can stifle experimentation. In the UK code, regular updates – those undertaken between periods of crisis – have added layers of provisions that, while nominally voluntary, have tended to rigidify practice. Moreover, in their reporting on compliance with code provisions companies often give only cursory explanations (Arcot, Bruno, & Faure-Grimaud, 2010; Shrives & Brennan, 2015). Doing so may hide well-meaning deviations from the code's specific recommendations and deprive us from learning from their mistakes and successes. Greater dangers arise, however. Codification may create a climate in which boards intentionally deceive or lead to an ethos of boards emphasizing compliance over value creation. The former undermines the code. The latter can lead, over time, to directors unthinkingly obeying code precepts. That risks making them what Smart calls 'the rules of some traditional moral system into which they have been indoctrinated in youth' (Smart & Williams, 1973, p. 7).

This discussion reminds us of the distinction drawn earlier between rule-based approaches to ethics and act-based ones. Taking a pragmatic, contingent approach, under what circumstances might act-based ethics (deontological or consequential) be better the rule-based ones? For that let us return to the three fictionalized cases outlined above: End Run, Spleen, and Petroleum Beyond.

BOARD ETHICS IN THREE CASES

In all three cases, the boards face situations of strategic significance. Let's imagine ourselves as their directors facing these corporate-life-changing decisions.

The Ethics at End Run

End Run faces great destruction of market capitalization if it internalizes the bad contracts parked offshore and off-balance-sheet. Its real-life counterpart, Enron, collapsed completely, so great was the problem, so massive was the fraud, as courts later found. We don't know whether End Run's situation is quite so precarious, and we, the board, have taken legal and accountancy advice that our actions are within the bounds of business judgment,[3] if rather near the edge.

We could follow the rules, the legal and accountancy equivalents of traditional morality, into which we have been 'indoctrinated since youth,' or at least since our early days in business. If sued by shareholders, we could stand behind our professional advisers and their opinions, which the company has paid for and has in writing, albeit with a sentence or two we wish they had not included. One of us – the CFO – is in a more awkward position than the rest, being the notional shareholder and director of all the loss-infested off-balance-sheet vehicles. He has a letter from the CEO, an ambiguously worded statement of support, which external counsel helped to draft. The jurisdictions in which they are based are places sufficiently secretive that prying eyes are unlikely ever to unravel the details.

This deliberation makes clear, however, that we tend to distinguish between law and accounting principles on the one hand, and ethics on the other, and can illustrate why. A rule-based categorical imperative like Kant's might remind us to act in ways that we would wish to see made a general rule. Would we wish to be one of our shareholders right now? Maybe we are already. Maybe that is what makes us want to keep the matter hushed up. The directive of that rule sits uneasily in our gut. It is an intuition that Smart might consider irrational, but it does not easily subside.

What about an approach of rule-based consequentialism? In a very narrow sense of consequences, the rule might read like a finance textbook on economic utility: accept any action that yields net present cash flows discounted by our weighted average cost of capital. In view of the situation, however, the cost of capital is difficult to estimate because the market is a false one, lacking information we directors know but which is not (yet) known outside. Cash flows do not justify continuing at all without a significant change in our business model. There seems little prospect that any such changes would justify the current share price. The decision about internalizing the losses or leaving them parked offshore is immaterial, except in their timing. That rule, too, does not help us decide.

You may protest that these approaches consider the firm purely from a perspective of shareholder value. Partly true; it does suggest that unthinking adherence to shareholder value may mean that this "traditional morality" of business has become an ideology. For a wider view, let's look at the case of Spleen FC.

Gut Instinct at Spleen

We, the directors, know precisely what our shareholders value: mutual childish spite. Our gut is saying that they deserve whatever (little) they get. That may be a Kantian view of justice, though on a happiness calculation their welfare may not matter, as the rest of this section will illustrate. Let's agree, then, to ditch shareholder value as an operative standard on

which to base our ethical consideration, choosing instead a stakeholder-focused approach. Who are they?

Professional staff: Most of the players and the manager have come to the club in the legal personage of the private limited liability companies their agents have registered for them in a zero-tax, offshore jurisdiction. They live off the dividends they pay themselves. From that perspective they are not employees but contractors. Their legal personages are not human beings, not even sentient beings, so they might escape from being owed any duty under Kant's second statement of the categorical imperative: use no human being solely as means to an end. Let's set them aside (but see Box 1).

Box 1: Residual risk of non-shareholders

The argument for shareholder primacy is often based on the premise that shareholders are last in line for compensation if a company fails. That is, they bear the residual risk. This is contested, ethically, by counterclaims that employees are not fully protected by their contracts for the *psychological* investments they make in the firm. What applies at Spleen FC?

Do the players, or more accurately the private service companies through which they sell their skills to Spleen, have a residual risk in the decision? Many might not. As a rule, we could conclude that they are just hired guns, contracted to shoot on target.

But what if ...? A long-term member of the squad with considerable psychological investment in the club nears the final years of his playing career. Might those circumstances justify a claim, based on loyalty and talent, to be considered soon for employment as a coach? This points toward act- rather than rule-based decisions.

Employees: We have other workers, however: ground staff, box office, most of the physiotherapists. They would be hurt – some badly – were Spleen to be relegated to a lower division and set on a downward spiral. But there are other jobs in the sector and other sectors.

Directors: Forget them (us). Put philosophically, the moral question cannot be what I, individually, owe to myself, but what each individual director owes to each other. They (we) can fend for them(our)selves.

Competitors: This stakeholder category rarely figures in theories of social responsibility. But sport is different: its product *is* competition. Few would pay to watch Spleen FC play without opponents. What do we owe (deontologically) to our competitors? A good game. What utility rule can we adopt? The prolongation of this league as the most competitive in the world, raising revenues for the clubs, salaries (or payments to private service companies) for players, wages for ground staff, and invitations to better parties for directors. The league itself, while not a competitor *per se*, benefits too.

Fans: These stakeholders are very different from Spleen's other 'customers.' Advertisers and television companies who buy rights can go elsewhere. But fans are different. They are

more than customers, more than even loyal customers. In the past they were owners. Through some odd magic of collective memory and intergenerational learning they have imbued the club itself with meaning, a rare and valuable resource on which we directors now trade. They are a far more tangible exemplar of 'community' than most stakeholder analyses use. The meaning they hare created, however, might survive if the club were relegated, as other clubs' histories demonstrate. On a financial basis of utility, any rule-based approach might not matter all that much. But on a duty-based rule – thou shalt love thy fans with all thine heart, as they love thee – fans matter a lot, as it does on a rule-based on a utility measured by the greatest happiness, rather than by the present value of cash flows. Conditions associated with these rules mean that they read like those Smart says collapse into act-based approaches to ethics.

Overall, this analysis provides much evidence supporting a decision of the sort that the directors of Liverpool FC made in 2010. In those circumstances, in that action, duties and utilities aligned, across all stakeholder groups, bar one: the owners.

Petroleum Beyond – Beyond Question an Ethical Decision

The lessons we are learning – belatedly – about industrialization and climate point to a particular problem associated with utility calculations: the timing of the utility or happiness. Boards of directors regularly face decisions where the costs appear now, the benefits arise later, which creates a timing risk, which is magnified by imperfect information. The method of assessing utility involves discount rates: cash today is worth more than cash tomorrow, the time-cost of money. Lengthening the time between when costs and benefit arise makes the information used in the decisions increasingly imperfect. That makes risk look more like what Knight (1921) called uncertainty.

What is clear, however, is that this business involves unusually large externalities, for which carbon emissions are a reasonable proxy. First, not only does the company incur heavy upfront costs in exploration and development; the nature of the industry involves very long-term future flow of production combined with volatility of commodity prices. While the board could hedge the company's own short-term costs, it can do little about the long time-horizon of the investment. Second, the company's contribution to climate change comes not just from its decisions but also from the decisions of its customers and their customers. Who bears responsibility for carbon emissions – the efficiency in use – of the company's product? Answering those questions involves difficult utility calculations, and problematic assessment of where duty lies when responsibility for creation and use of the product are shared.

Fiduciary duty to shareholders comes into question as well, and not entirely in an abstract sense. Let's say that Petroleum (Giant or Beyond) is incorporated in Delaware, where company law permits considerable managerial discretion but nonetheless has been the seat of many shareholder lawsuits targeting directors – *us* – personally. Choosing a climate-friendly strategy with considerable risk of short-term damage to profitability is offset only by uncertain long-term future benefits. Lawsuits may follow, diverting management attention from getting on with the job. Directors are justified in maintaining a duty to act within the law. Deontological and consequential ethics seem inseparably tangled.

The real-life parallel, BP, is a British company, and therefore not based in Delaware. Its US rivals, including ExxonMobil, are, however. In UK law, director duties are articulated in the Companies Act 2006, which addresses stakeholder and shareholder interests with a legal fudge. While directors must show 'regard' for stakeholders, many scholars and lawyers read the main clause in that section (§172) as a statement of shareholder primacy (Tsagas, 2017; UK Parliament, 2006). BP decided to switch back to shareholder value, but then reversed that reversal several years later as issues of climate change loomed larger – on the political agenda and concerns of major institutional investors.

The crux of this chapter is not navigating legal questions, however. Law is just the currently understood approximation of ethics enacted through politics. And in all three cases, ethics concerns not just the individual director but the collective decisions of boards. How should they, collectively, decide?

DIRECTING TOWARD DECISIONS

These cases share certain features. All three involve strategic, possibly existential decisions. They demand attention of boards and preferably a collective decision without provoking resignations. Dissenting voices should be accommodated, or at least heard with respect. Let's consider process, reflecting it against the philosophical discussion above.

Baseline Bias in Ethical Orientation

Individual directors are likely to come to the board with an enculturated predisposition toward either duty- or utility-based ethics, a heuristic that others on the board may not share. Diversity of disposition is likely to be greater if the cultural diversity of the board is greater and if the ethos of the board is one that invites challenge. We might expect to see duty and utility ethical orientations operating in background. They may not be fully articulated but still present and seeking acknowledgement in whatever decision is reached by the group.

Group Decisions

Collective decisions are likely to arise through persuasion and negotiation, the former achieved with arguments and personality, the latter through compromise. In his companion piece to Smart's, Williams notes that much ethical theory focuses on the morality of individuals, not of social or political systems (Smart & Williams, 1973). Boards may not be what he had in mind as social systems. But boards meet only episodically, are notionally non-hierarchical, and have mechanisms to prevent excessive personal cohesiveness or commonality of viewpoint. These factors suggest they may act like complex social systems. Their elite composition means they may also reach substantive decisions more as individuals than social systems would.

Act-based Reasoning, Rule-based Shortcuts

Because these are strategic decisions, we are from the outset inclined toward act-based ethical reasoning, rather than rules. Law and regulation are rather blunt instruments and become problematic in helping to navigate intricacies of complex situations. Codes of conduct provide more granular guidance for boards, but they frequently defer in favor of *board* (not *managerial*) discretion through mechanisms like comply-or-explain (which boards may ignore or use perversely; see Box 2).

Box 2: How rules backfire

Heuristics have biases, and blind spots. When decision rules obscure the assumptions on which they are based, perverse outcomes may arise. A case in point:

A recommendation, which appeared first in the 2003 version of the UK code, threw into question the independence of non-executive directors after three three-year terms. It quickly came to be called the 'nine-year rule.' It is not a *rule* – it is couched in terms of *should* not *must* – but in practice it was often treated as an imperative.

Some years ago, the board chair of a large UK company spoke proudly of how he had orchestrated the departure of a non-executive director six months ahead of the end of the ninth year. The board evaded confrontation with investors and proxy voting agencies. The chair then added: This director had been the hardest working non-executive. He had specialist knowledge of a sector, profession, and country in which the company faced a crisis.

This incident illustrates Smart's argument that rule-based decisions easily collapse into act-based ones. Or rather, *should* collapse.

Rules, even rule-deontological ones, have utility. They can be shortcuts to decision, not least because they conserve a scarce resource of boards – the attention of directors. Utilitarian or deontological rules may not yield the right outcome, but they often provide something 'good enough' (evolutionary biology might have organizational parallels; see Nordberg, 2020a). But act-based ethics, deliberated and negotiated between varying duty- and utility-based perspectives, seems more appropriate, and more so the more strategic the issues are.

RESEARCH DIRECTIONS

This chapter illustrates how ethical issues arise and could be treated in practice. Research into cases like those sketched above, and others concerning both strategic and routine decisions, can help to verify whether this argument is a pragmatic one, one that works. Work on thresholds between rule-based and act-based decision-making would show the potential tailoring decisions to fit the contingent factors of each case.

The decision processes of groups warrant further examination on their ethical dimensions. Within that area, the special circumstances of boards will require different approaches. Board research is particularly difficult to conduct in general, but the growing practice of board evaluation exercises has opened a channel where ethical considerations will arise as part of the process (Nordberg & Booth, 2019). Provided that confidentiality can be maintained, this route might help us see how duty- and utility-based predispositions interact in practice and how such interplay affects movement to consensus.

By focusing on act-based ethics, this chapter has begged but not answered the question of the value and the limitations of regulating the works of boards. Repeated crises provoked repeated efforts to tighten guidance over increasing aspects of board conduct. The success of such efforts has created greater transparency but also worries that it is driving companies away from listed to private equity markets, with even less transparency and investor protection. Consultations on regulatory actions – whether of codes or legislative measures – have generated heated exchanges about the effect such actions have on the twin roles of directors, control and service. Studying consultation discussions in detail could provide nuances views of the ethics in board work without the difficulties of gaining direct access to confidential board discussions.

There are also theoretical questions with links to applied ethics and boards that deserve attention. We have seen suggestions that ethics may be an outcome of evolutionary biology and a source of selective advantage. There is justification for that in the parallels to what Kahneman (2011) calls System 1 thinking, what makes us avoid danger by bypassing the reasoning – the mental effort – to calculate a better – more calibrated decision. Is traditional morality the ethical equivalent of System 1? If so, how can, or should, such rapid assessment of morality be treated by boards seeking to bring rationality to bear?

Another is this: Is traditional morality, the deontological, deep-seated sense of ethics, a product of enculturation, rather than transcendental, categorical, or biological? An intriguing argument has developed at the intersection of economics and ethics, which might have application in management studies and the study of boards. The game theorist Kenneth

Binmore (2005) asks us to consider traditional ethics – the sense of duty and revulsion we feel – as an interim outcome of a game that has been running for millennia (and not just centuries). It is a game like the famous Prisoners' Dilemma, but one in which the rules are shared between collaborating parties, who learn from each other's mistakes, and then pass the lessons on to children and grandchildren, using a shorthand of heuristics. This is a cultural rather than genetic inheritance, nurture not nature. It is the result of repeated experimentation and learning, perhaps using moral imagination (Cf. Rorty, 2006; Werhane, 2002). Over time, shortcuts may reduce to aphorisms and become *a priori* rules, which come to be taken for granted. The assumptions used in the original heuristic get lost along the way. As circumstances change, thinking people begin to wonder whether the maxim we wish to become a general rule may no longer fit. Is rule-deontology a special case of act-consequentialist thinking with special circumstances, through forgetfulness, ignored?

CONCLUSIONS – ETHICS AS THOUGHTFULNESS

This chapter has focused on decision-making based on getting elite workgroups to come to a collective decision using a negotiated approach bringing deontological and consequential ethical justifications together and balancing them pragmatically. That is not because pragmatism is *the* correct ethical stance. Pragmatism doubts the possibility of one right way. It is instead the right way to get things done, given uncertainty and the lack – and quite likely the impossibility – of perfect information. My argument further suggests that rule-based versions of either can help boards, pragmatically, to respond to pressure on directors' time and attention. Act-based ethics, however, is preferred when time allows.

A pragmatic view of ethics might be summarized in this way. Assess what rules seems to apply, around the boardroom as well as among the range of people who might be affected by the decision. Assess the basis of those rules, whether the assumptions behind them fit the circumstances of this decision. With a mix of personalities and backgrounds among well-meaning, conscientious directors, and an ethos of challenge among rough equals, debate will generate a variety of justifications.[4] Important decisions require both attention and time, and examination of the details of each act, using the best available information, and with the humility to recognize that the board may get it wrong. A lesson from real options is germane: experiment, commit as late as possible, in stages if possible. Unexpired options have value.

Let's recall that Hendry (2004) argued that boards operate in bimorality, a fracture between traditional ethics and the morality of self-interest enacted through markets. These facets point us to be alert to nuances in decision-making that involve elements of both. Let's

recall too Foucault's distinction between compliance with rules and the ethical person's consideration of complexities. He associated the former with traditional morality, the latter with a reasoning approach, aware of contingencies and alert to nuances. These approaches point to the need above all for thoughtfulness, awareness of the factors that matter. They argue also for humility in decision-making, and the willingness to listen to divergent views, leaving options open to backtrack, divert and shift when thing go a different way than planned.

The pragmatist's view is a humble one. We do not know with certainty about the outcomes of a decision, in Smart's terms its rightness, nor even whether Smart was right in favoring utilitarianism or Williams in opposing it. We can approach it, however, with the hope that our agency, our decision, is one that works. If it doesn't, we may still be able to try something else.

BIOGRAPHICAL SKETCH

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ENDNOTES

[1] This version of the imperative is now often discussed in terms of 'sentient beings.'

[2] Pluralism is an important theme elsewhere in writing that embraces elements of pragmatism (e.g., Berlin, 2013; Walzer, 1995).

[3] The term 'business judgment' arises in the context of Delaware law as a threshold that must be passed before courts will entertain shareholder lawsuits. Seen as management-friendly, this legal system has long made Delaware by far the US state most favored for incorporation. Enron was among the many firms that made it their legal seat.

[4] This observation suggests that understanding thoughtfulness in corporate governance and business ethics generally involved understanding virtue ethics. See Marchese, Bassham, and Ryan (2002) and Akgün, Keskin, and Fidan (2021).

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