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## **After shame; before corporate moral obligation (CMO): ethical lag and the credit crisis**

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Gwendolyn Yvonne Alexis\* and  
Steven Pressman

Leon Hess Business School,  
Monmouth University,  
400 Cedar Avenue – West Long Branch, New Jersey, USA  
E-mail: galexis@monmouth.edu  
E-mail: pressman@monmouth.edu  
\*Corresponding author

**Abstract:** The global financial crisis brought down some of the world's largest and most well-established financial institutions. In an area of business activity where tradition and trust are said to count for much, astonishing levels of open criminality, venality, and willingness to exploit weak regulatory structures were brought to light by the financial crisis. This paper is a paraenetic comment on that crisis. It is an exhortation to better business practices, a recognition that the crisis was brought about because the old sanctions of shame and regulation failed to deter unethical behaviour. The paper reviews some of the reasons for this and introduces the idea of corporate moral obligation (CMO) as an alternative ethic. We suggest that CMO better captures a universal commitment to unwavering values than does the more utilitarian approach of weighing the interests of various stakeholders, many of whom lack the power to secure what is their rightful due. In commending CMO, we do not aim to anticipate every objection but rather to encourage consideration of one possible way of overcoming the ethical lag exposed by the global credit crisis.

**Keywords:** credit crisis; regulatory capture; regulatory agencies; corporate social responsibility; CSR; Sarbanes-Oxley Act; systems theory; greed; shame; moral obligation; business ethics.

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**Biographical notes:** Gwen Alexis is the Lead Instructor for Business Ethics at Monmouth University, W. Long Branch, NJ. She is a Corporate Attorney, has worked both in private industry and the public sector – most notably in the Enforcement Division of the Securities and Exchange Commission. She is a member of the NJ Supreme Court Ethics Committee, a body that adjudicates attorney disciplinary matters; and a Commissioner on the NJ Corporate and Business Law Study Commission. She has a JD from Harvard Law School, a Masters degree in Ethics from the Yale Divinity School, and a PhD in Sociology from the New School for Social Research.

Steven Pressman is a Professor of Economics and Finance at Monmouth University in West Long Branch, NJ, a North American Editor of the *Review of Political Economy*, and an Associate Editor and Book Review Editor of the *Eastern Economic Journal*. He has published more than 140 articles in refereed

journals and as book chapters, and has authored or edited 15 books, including *A New Guide to Post Keynesian Economics* (Routledge, 2001), *Alternative Theories of the State* (Palgrave/Macmillan, 2006), and *50 Major Economists*, 2nd ed. (Routledge, 2006), which has been translated into five different languages.

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## 1 Introduction

“If cash comes with fame, come fame; if cash comes without fame, come cash.” Jack London, in a letter dated November 1, 1899 (Carruth and Erlich, 1988)

London’s pithy commentary is a suitable summation of the theme of this paper, to which we would only add, “And, if infamy comes with cash; come infamy”. As an attorney and an economist examining the various professional and ethical lapses that led to the present credit crisis, the authors have detected a consistent willingness on the part of the decision-makers at financial institutions to prioritise corporate profits over corporate propriety. Well-respected financial institutions were willing to abandon time-worn industry standards of credit-worthiness in granting homeowner loans because meeting those standards would have hampered their ability to accumulate the maximum amount of mortgages to bundle for selling in the lucrative secondary market for mortgage-backed securities – a process known as ‘securitisation’.

With securitisation, the total becomes greater than the sum of its individual parts – the parts being mortgages which should never have been granted in the first place. But, they were granted because mortgage originators were not concerned with the ability of individual homeowners to pay the mortgages since the mortgages were going to be sold off. Given that the highest interest rates could be extracted from the least credit-worthy borrowers, high-risk loans made for a very attractive package. Obtaining high-end appraisals for the properties was often easy since the appraisers were selected by the lenders, who had a propensity to retain appraisers who delivered the high-end appraisals that they desired and discard those that did not. While it may be economically justifiable for financial institutions that will be selling debt outright to be more concerned with the attractiveness of the overall package being marketed than with the quality of the underlying loans, it is risky behaviour when viewed from the standpoint of legal liability and from the standpoint of the long-term stability of the economy. Where it can be shown that mortgage originators granted loans to obviously unqualified borrowers, the purchasers of those mortgages can assert a claim of negligence against the mortgage originators for failure to exercise due care (Murray, 2008). Furthermore, the business model of assembling and marketing high-risk mortgages of steadily decreasing quality falls far short of the Uniform Commercial Code (UCC, <http://www.law.cornell.edu/ucc/1/article1.htm>) definition of good faith; to-wit, “Good faith... means honesty in fact and the observance of reasonable commercial standards of fair dealing” [UCC § 1-201(20)].

We attribute the ease with which these lending institutions cast aside their traditional banking model to partake of the riches to be earned in the originate-to-distribute model to pure and simple avarice. In an industry that attracts (and retains) consumers based upon trust, it is surprising that fear of loss of reputation did not serve to ward off the pursuit of

profit-maximisation at any cost. A study conducted by PricewaterhouseCoopers in 2002 indicated some concern on the part of financial institutions over a well-documented loss of public confidence in the management of financial institutions as a result of the corporate accounting scandals epitomized by Enron, WorldCom, and the like. This study was memorialised in a PricewaterhouseCoopers ‘White Paper’ that called on the boards and audit committees of these financial institutions to respond to the public mandate for corporate reform [PwC (2003), p.1]. However, concern with the diminished stature of financial institutions was not so great as to motivate these institutions to steer clear of the high-risk, profit-seeking opportunities that led to the present credit crisis. Of course, greed had triumphed over concern for corporate repute in an earlier series of scandals; namely, the savings and loan crisis of the 1980s, the corporate accounting scandals at the dawn of this millennium, and the stock options backdating practices that came to light while regulators were still dealing with the corporate abuses of Enron and progeny.

We labour under no misconception that we can remove greed as a motivator for human behaviour or corporate action. Likewise, we are not concerned here with delving into theories of legal liability or with evaluating economic strategy; rather, our objective is to motivate a raised standard of ethical conduct for the corporate enterprise. Lax ethical standards allowed a number of pedigreed financial institutions to grant mortgages to unqualified consumers, thereby enticing them to trade up from their presumably affordable housing arrangements when it was virtually certain that the result would be a nightmare of foreclosure, eviction, and eventual homelessness. Moreover, the lenders involved in this intentionally amoral behaviour breached their duty to uphold the professional standards of the financial industry by conducting their businesses in accordance with best practices within the industry [Carroll and Buchholtz, (2009), p.291]. Hence, our purpose here is the task of charting a new path towards a raised bar for ethical conduct in the business/society interface. We begin this journey by acknowledging the fact that societal disdain no longer suffices as a deterrent to predatory or criminal behaviour.

## **2 The end of shame as a deterrent**

### *2.1 Shame as a constraint*

The relationship between law and morality is a double one. The law is an expression of society’s moral code for if an activity were not thought a breach of that code it would not long remain unlawful. But the law also re-enforces the moral code by both punishing and shaming those who violate it, while holding out the hope of re-integration into society for the violator who has been rehabilitated. Noted Australian legal scholar John Braithwaite and other criminologists have discussed the ability of shame to lower the likelihood of recidivism among criminals, arguing that the process of shaming is even more important in the reduction of crime than court-imposed sanctions [Ahmed et al., (2001), p.73]. In his theory of reintegrative shaming, John Braithwaite identifies two types of shaming – shaming that stigmatises (i.e., which brands the offender as a permanent outcast) and *reintegrative shaming* that is paraenetic in nature in that it appeals to an individual’s moral values and conscience (Braithwaite, 1989).

Shame did play a large part in the development of Western culture. As noted by historian Johan Huizinga (1919/1996), the Middle Ages were a time of religious

hegemony and fierce punishments imposed for moral decadence. The ultimate penalty for any infraction, of course, was spending eternity in 'hell'. Nonetheless, because there were few social sanctions operating at the time, such penalties had little effect on individual behaviour. Hence, in medieval times, unrestrained licentiousness was the order of the day. In a seminal sociological study, *The Civilizing Project*, sociologist Norbert Elias (1939/1969) stressed the role of shame and social stigma in influencing human behaviour. Elias documents how rising norms and social sanctions transformed post-medieval standards regarding table manners, violence, and public drunkenness. He posits the ability to engender a sense of shame as having been vital in terms of implementing new societal norms and conventions such as bathing regularly, eating with utensils, and not relieving oneself in public. So, as Western society developed, the failure to act appropriately led to social disgrace, stigma and possibly even ostracism.

In *The Theory of Moral Sentiments* Adam Smith also wrote of the importance of shame and remorse as a constraint on human action:

“The violator of the more sacred laws of justice can never reflect on the sentiments which mankind must entertain with regard to him, without feeling all the agonies of shame, and horror, and consternation. When his passion is gratified, and he begins coolly to reflect on his past conduct, he can enter into none of the motives which influenced it. They appear now as detestable to him as they did always to other people ... He dares no longer to look society in the face, but imagines himself as it were rejected, and thrown out from the affections of all mankind. ... The horror of solitude drives him back into society, and he comes again into the presence of mankind, astonished to appear before them, loaded with shame and distracted with fear, in order to supplicate some little protection from the countenance of those very judges, who he knows have already all unanimously condemned him. Such is the nature of that sentiment, which is properly called remorse; of all the sentiments which can enter the human breast the most dreadful. It is made up of shame from the sense of the impropriety of past conduct; of grief for the effects of it; of pity for those who suffer by it; and of the dread and terror of punishment from the consciousness of the justly provoked resentment of all rational creatures.”  
[Smith, (1854/2000), pp.121–22]

As much literature in game theory and evolutionary game theory has shown, humans are communal by nature; they survive by cooperating with neighbours and others. The collective has always been important. If the caveman had only focused on his own self-interest, the human species would not have survived, let alone evolved. Ethical behaviour is largely dependent upon how other people behave. This is clearest in the case of experimental research on the prisoner's dilemma. As Dawes (1980) summarises, the behaviour of any person is strongly influenced by what that person thinks others will do or how they think others behave. If others are behaving ethically, people have a tendency to do so also. On the other hand, if others are not behaving ethically, there is a feeling that one does not want to be a chump and so there is less likelihood of ethical behaviour. If others are cheating; there is an implication that cheating is the norm and, thus, it is acceptable to cheat. This means that strict enforcement and warding off a culture of cheating becomes important. In the world of business, this means that sanctions against fraud must be stiff. Anyone considering fraudulent activity must know that they are weighing small gains (because large gains are heavily taxed) against a high probability of being caught, with severe sanctions and public opprobrium to follow.

There were social sanctions aplenty for failing to conform to prevailing norms in Colonial America, most notably in the Puritan settlements of New England where church

attendance was mandatory under penalty of fine or imprisonment [Holifield, (1994), p.25]. At a time when religion served as a means of societal control, there was mandatory religious taxation which went to support the Congregational churches of the Standing Order of New England. In fact, Massachusetts did not abolish its mandatory church tax until 1838. Sociologist Max Weber took note of the very real impact of religious affiliation in the everyday lives of the early US settlers, noting that “during the colonial period in the central areas of New England, especially in Massachusetts, full citizenship status in the church congregation was the precondition for full citizenship in the state” [Weber, (1946), p.312]. There is no surprise in this; in Colonial New England, the local church was the organising centre for social life and the main site for social interaction. This is a far cry from the social situation in the USA today; however, there are observers of the criminal justice system who are calling for renewed attention to sociological factors, such as assessing the role shame plays in deterring criminal activity (Pressman, 2008).

## 2.2 Multiculturalism and a digital age

“Consequently, to know if a moral fact is normal for a society, we must take into account the age of the society and determine the normal type which serves as landmark. Thus, during the infancy of our European societies, certain restrictive rules of liberty of thought which have disappeared in a more advanced age were normal.” [Durkheim, (1933), p.433]

In the liberal democracies of the West, multicultural living has become the norm. The cities of Europe – in which 80% of the European population resides – have become racially, ethnically, religiously, and culturally diverse as a result of an unprecedented migration of non-Western peoples to the immigrant host nations of the West during the last quartile of the 20th century. The USA is experiencing *deep* diversity for the first time due to a change in its immigration laws in 1965 ending the discrimination against non-European emigrants [Hing, (1993), p.79]. Today, taking up residence in a particular society does not necessarily entail embracing all of its values or adhering to its customs. Moreover, it is unlikely that non-conforming behaviours will result in ostracism from the greater society. There is simply more tolerance for nonconformity in this global age of multicultural communities.

In this changed societal environment, it is no surprise that shame is not the deterrent to aberrant behaviour that it once was. The tattoos, body piercings, religiously-dictated grooming habits (beards, dreadlocks) and modes of dress (*yarmulkes*, *hijabs*, turbans) that are everywhere evident in today’s Western societies manifest personal choices not to ‘blend in’, and serve to lessen any stigma associated with marching to the beat of one’s own drummer. Indeed, ease of travel and advances in internet technology have made it easier to connect with and get to know ‘the other’. This has resulted in societal notions of appropriate public comportment becoming less uniform, regardless of the society. Moreover, ease of unfiltered communication (e.g., social networking sites) as well as relaxed censorship standards for risqué subject matter – e.g., Twitter.com, Facebook®, reality TV shows and tell-all TV programs of the Judge Judy and Jerry Springer Show genre – have blurred the distinction between public and private realms.

With around-the-clock coverage of all aspects of life and death, the possibility of public ridicule has lost its sting. Certainly at the societal level, the pursuit of fame (even if for just 15 minutes) has eclipsed the quest for privacy, thereby stripping

'notoriety' of the negative connotations it once had. It is worth noting that there are two unstated presuppositions underlying Braithwaite's theory of reintegrative shaming:

- 1 that the person violating society's moral code will suffer ostracism
- 2 that the violator will experience remorse and want to become reintegrated into society.

Both of these presuppositions are highly speculative notions in today's liberal 'live and let live' Western societies. Similarly, in the world of business – where new economic legislation to control predatory business practices has been on the wane for a number of years and is coupled with a rising trend toward deregulation [Carroll and Buchholtz, (2009), p.470] – fear of regulatory action no longer suffices to ward off a corporation's single-minded pursuit of self-interest.

### *2.3 Financial deregulation*

Until the 1980s, banking was a boring business. Kregel (2008) describes it as a 3-6-3 job. Banks would borrow money at 3%, lend it at 6%, and bankers would tee off on the golf course by 3 pm. This world of banking was the outcome of numerous regulations imposed during the Great Depression. There were limits on the interest that banks could charge, limits on the sort of risks they could take with deposits insured by the government, and limits on the interest they could pay savers.

Not everyone was happy with this system. Some bankers wanted the opportunity to earn more money. The only way they could do this was to get rid of government regulation, allowing them to make riskier loans and charge higher interest rates. So, they argued that regulations hurt the economy because many new companies, homeowners, college students, and consumers were locked out of the loan market; this loss of borrowing and spending, in turn, slowed down economic growth and job creation. Bankers also pushed for ending or limiting other regulations – for example, the capital that banks had to put up whenever they lent out money. Capital requirements ensure that bank shareholders risk something when banks make loans, and so discourage financial institutions from taking on too much risk. With the election of Ronald Reagan in 1980, free-market economics received a huge boost. The Garn-St. Germain Depository Institutions Act of 1982 was passed, which deregulated credit unions and savings and loans. Non-bank banks (mortgage companies, payday lenders, and hedge funds that take in money and make loans) were allowed to open and to make loans. These financial institutions grew rapidly, unhampered by the many restrictions on banks. They gave depositors and investors higher returns on their money, and lent money to riskier borrowers at higher interest. This put banks at a competitive disadvantage; money flowed out of banks and into other financial institutions. It also increased the pressure to deregulate banks, so that they could compete with lightly regulated non-bank financial institutions. President Reagan appointed Alan Greenspan, another true believer in the free market, to head up the Federal Reserve in 1987. The Greenspan Fed reduced its monitoring and regulation of financial institutions, and 'reinterpreted' existing laws to relax restrictions on banks. Greenspan also allowed the financial industry to speculate on financial derivatives (or place bets on their future prices).

Institutions that fell short of existing regulations were sometimes given warnings or a slap on the wrist. Sometimes rules were bent to aid the financial industry. In many cases,

regulatory authorities just looked the other way as financial institutions stonewalled them. If that did not work, politicians were pressured (sometimes with large financial contributions) to keep regulatory institutions off their backs. The Keating Five (five US Senators accused of corruption for making overtures on behalf of banker Charles Keating) became infamous in 1989, but in many other cases behaviour of this sort did not make news headlines.

The emphasis on financial deregulation continued into the 1990s. In 1994 President Clinton signed the Riegel-Neal Interstate Bank Efficiency Act, which repealed restrictions on interstate banking. This fuelled the rise of mega financial institutions that became too big to let fail. The Glass-Steagall Act of 1933 was repealed when President Clinton signed the Gramm-Leach-Bliley Bill in November 1999. A New Deal reform, Glass-Steagall established deposit insurance (the FDIC); it also limited the risks that commercial banks could take with insured deposits. Under Glass-Steagall, a bank could either receive deposits and make loans, or it could sell securities. It could not do both. If a commercial bank made a loan, it had to keep that loan on its books, since it was prohibited from selling this security. This was a key foundation to the 3-6-3 world of banking.

Repealing Glass-Steagall meant that banks could sell off their mortgages. Instead of making money from taking in deposits and lending the money at a higher rate, banks were now in the business of approving loans, packaging them, and then selling the package. We had a new business model for banks. Rather than making loans with a large probability of repayment, the incentive now was just to make more loans. Each loan earned the bank a fee, and since the loan was going to be sold off, there was no reason to worry about what would happen if the loan was not repaid. So we got 'liar loans' (where people were counselled to lie about their income and assets to obtain a mortgage), loans with no income check, and loans with no money down. Borrowers were told that housing prices would always rise, and they would always be able to refinance before their low-interest teaser rate expired and their mortgage interest rate shot up. All that mattered to the bank was getting a signature on the dotted line.

But to sell these loans, they had to be seen as being safe investments. One way to do this involved packaging a bunch of mortgages together into a single financial instrument, the mortgage-backed security (MBS). By combining a bunch of mortgages, there would be safety in numbers, or so it was thought. One, or even a few of the mortgages in a package of securities might go into foreclosure, but the entire package would likely continue to pay interest to its owner when mortgage payments would be made on most of the original loans comprising the package.

Rating agencies (such as Moody's and Standard and Poor's) give all securities grades, such as AAA, AA, A, BBB, equivalent to the grades A+, A, A-, B+, etc. that teachers give students. These ratings are supposed to reflect the probability of default on the security, or the chance that the owners of that security will not get paid as promised.

Investors would not buy an MBS unless they thought it was safe, rather than a package of junk mortgages that were all likely to wind up in foreclosure. Average investors do not have the expertise or the time to evaluate each MBS package. Therefore they rely on the assessments made by 'the ratings experts'. Additionally, since institutional investors (such as pension funds and governments) are prohibited from investing in anything except top-rated securities, access to this market is facilitated by having ratings agencies assign high grades to one's securities offerings.

The big problem with this system is that rating agencies are paid by the institution seeking to sell a security. The profits of the rating agency, as well as the pay and the continued employment of its employees (who do the actual rating), depend on getting business from firms seeking to sell securities. A low rating would jeopardise the livelihood of the rating firm and its employees, since large financial institutions could easily shop around for another rating agency willing to give higher ratings. Since they could not afford to lose large corporate clients like Countrywide Financial, rating agencies gave all their MBS's a top rating. As such, the system became rife with conflicts of interest. This problem was first pointed out by Cantor and Packer in 1994, but rating inflation became much worse during the 2000s due to the rise of large financial institutions.

#### *2.4 Consent agreements*

Consent agreements allow the wrongdoer to pay a monetary fine to a federal regulatory agency under terms not requiring an admission of guilt. They contribute to the absence of social stigma for having broken the law in the first place. These consent decrees speak more to the remorse of the regulatory agency for having interrupted the status quo than to the illegitimacy of the activities that motivated the regulatory agency to launch an investigation in the first place.

A case in point is the reemergence of Lou Pai (the Enron executive who made a \$270 million profit by bailing out of Enron before it bit the dust) as an unsullied energy czar. This time around, Pai is a major investor in Element Markets of Houston (EMH), a carbon management and alternative energy company that has a business line in renewable energy credits (RECs). The US Securities and Exchange Commission (SEC) instigated an enforcement action against Pai, charging him with insider trading. However, Pai was allowed to enter into a consent decree with the SEC, under which he forfeited less than 10% of the \$270 million profit he earned from precipitously selling his Enron shares. Surprisingly, the settlement agreement did not bar him from ever again becoming a major shareholder of an energy company; nor did it require Pai to admit that he had been involved in insider trading. Today, the unrepentant Pai is investing heavily in EMH in an attempt to corner the market on RECs (Fallows, 2009).

By allowing Pai to slide by with nothing more than a monetary penalty, the SEC missed an opportunity to stigmatise him as a marked man – someone whose wrongdoing had resulted in him being barred from ever again being associated with the securities markets. And viewed from Pai's standpoint, he has little reason to hang his head in shame since the consent decree that he entered into did not even require him to admit that he had traded on inside information. And yet, the SEC cited its handling of the Pai matter as one of its important accomplishments during the 2008 fiscal year:

“The Commission [S.E.C.] charged Lou Pai, the former chairman and CEO of Enron Energy Services, with selling Enron stock on the basis of material, nonpublic information. Pai simultaneously settled the action *without admitting or denying the allegations in the complaint*, and agreed to pay \$30 million in disgorgement and prejudgment interest (subject to a \$6 million offset based on his prior waiver of insurance coverage for the benefit of Enron investors), plus a \$1.5 million civil money penalty.” [SEC, (2008), p.112] (emphasis added)

The extent to which the SEC is willing to allow corporate wrongdoers to pay monetary fines ‘without admitting or denying’ the allegations contained in an SEC complaint has



reached epic proportions. In Appendix B of its report for the 2008 fiscal year, the SEC describes the outcomes of the ‘major enforcement cases’ that it handled during the year. The seven cases – all settled by consent decrees – involved United Rentals, Inc. (engaged in fraudulent transactions to meet earnings forecasts and analyst expectations); Biovail Corporation (fraudulently overstated earnings and hid losses); executives of AOL Time Warner, Inc. (bogus transactions resulting in *\$1 billion* overstatement of advertising revenue); Broadcom Corporation and five of its officers and executives (fraudulent backdating of stock options necessitating a *\$2 billion* restatement of earnings); CEO of UnitedHealth Group, Inc. (fraudulent backdating of stock options necessitating a *\$1.5 billion* earnings restatement over an *11-year period*); executive of Kellogg, Brown and Root, Inc. (bribery of Nigerian Government official), and Schnitzer Steel Industries, Inc. and its CEO (improper gift to Chinese Government-owned steel mills). Despite the egregiousness of the crimes committed, each case was settled for monetary sums with no requirement that the alleged violators admit their guilt [SEC, (2008), p.110].

To the SEC’s credit, it did bar the CEO of UnitedHealth Group, Inc. – William W. McGuire, M.D. – from serving as an officer or director of a public company for *ten years*. Nonetheless, he was not required to admit that he had signed and approved backdated documents in order to have the option dates coincide with historically low quarterly closing prices for UnitedHealth stock. The willingness of the SEC staff attorneys to negotiate these limp consent decrees is no doubt motivated in part by the fact that the SEC is too short-handed and under-funded to litigate even what it classifies as ‘major cases’ of securities fraud. Nevertheless, the resurgence of Lou Pai demonstrates that the financial industry would benefit if regulatory agencies such as the SEC would help rid the industry of recidivist white collar criminals by making it a policy to stigmatise these wrongdoers in their consent settlement agreements.

Particularly for regulated corporations with an elite corps of attorneys and accountants at their disposal, the knowledge that should they be found to have engaged in illegal activities, there nevertheless remains the possibility of negotiating for leniency with the staff of federal regulatory agencies (staff who will eventually be in the market for a job within private industry) provides no disincentive to seeking out grey areas of the law. Hence, it is typical for firms to engage in a cost/benefit analysis when confronted with an opportunity to maximise profits by engaging in activities that are clearly unethical, but have yet to be declared to be in violation of the laws and regulations administered by a particular federal agency. The lightheartedness with which corporate elites view the rule of law and any regulations enacted thereunder – i.e., as being prescriptive rather than proscriptive – serves to demean the justice system and perpetuates the widespread public sentiment that ‘the rules don’t apply to the big guys’. Settlements by consent should contain terms that punish and language which indicates the violator’s admission of guilt as well as contain an expression of remorse in order to make it patently clear that the violator has engaged in socially reprehensible behaviour.

### *2.5 The celebration of business notoriety*

It is often argued that in many poor inner city neighbourhoods, having served jail time is a badge of honour for male teenagers. Hence, it is unlikely that shame is an effective deterrent to juvenile delinquency in these neighbourhoods. An analogy can be drawn between these wayward youth and the white collar criminals who served as managers, officers and directors of the financial institutions that contributed to the credit crisis. For

them, their badge of honour is having pursued profit maximisation for their corporate employer, even where this pursuit of profit led to untold misery for others stakeholders such as the hopelessly delinquent mortgagees losing their homes and the rank-and-file corporate employees who lost their jobs when the corporation started going under. An example of this type of white collar criminal is Angelo Mozilo, the former CEO of Countrywide Financial.

At one point Countrywide financed a fifth of all US mortgages. Mozilo aggressively promoted sub-prime mortgages, thus playing a major role in making Countrywide the nation's largest mortgage lender. Then, by selling his stock in Countrywide before it collapsed, Mozilo became a multi-millionaire. Yet, while engaged in the liquidation of his own stock holdings, he was telling investors that everything was fine with Countrywide. He was also simultaneously sending e-mail messages to other senior executives describing the 'poison' sub-prime mortgages that Countrywide had granted with no money down (SEC, 2009b). His false information to investors helped inflate the price of Countrywide stock and made it possible for him to sell out at much higher prices. Then, adding insult to injury, Mozilo used his ill-gotten gains to buy up the foreclosed properties of Countrywide mortgagees for pennies on the dollar.

On July 1, 2008, Countrywide merged with Bank of America and on that same day the New York Stock Exchange delisted and deregistered Countrywide's stock. Countrywide is now a wholly owned subsidiary of Bank of America. Nonetheless, Mozilo continues to defend Countrywide because it made home ownership widely available to the American public (ignoring the fact that many homeowners are now defaulting on their loans and losing their homes to foreclosure). Additionally, Mozilo has defended his exorbitant compensation at Countrywide as justified because of the huge profits made by Countrywide before the financial collapse. On June 4, 2009, the SEC filed charges against Mozilo for securities fraud and insider trading (SEC, 2009a). Right before the trial was scheduled to begin in October 2010, the SEC settled with Mozilo for \$67.5 million in penalties and reparations to Countrywide investors. Of this sum, \$20 million will be paid by Countrywide/Bank of America – not by Mozilo. The financial penalty imposed was just a small fraction of the \$260 million that Mozilo made from dumping his Countrywide stock between 2005 and 2007. Under the consent decree, Mozilo was barred from ever again serving as an officer or director of a publicly traded company. However, under SEC consent decree policy, the accused are never required to publicly admit or deny their guilt. Hence, Mozilo was not forced to experience the public opprobrium he rightfully deserved for contributing to such widespread financial ruin.

This case shows that because white collar criminals like Mozilo are generally well educated, highly respected and often influential individuals (Sutherland, 1949), they are handled with kid gloves by the judicial system, receiving at most a few years in one of the so-called country club penal facilities. Glorification of infamy is perpetuated when, after serving a cursory imprisonment, 'reformed' white collar criminals hit the lecture circuit, become sought-after guests on TV talk shows, or start a church as did born-again Watergate defendant Charles Colson. Some even emerge from prison with wealth and fame. For example, Nick Leeson's illicit options trading led to the collapse of Barings Bank, a staid British financial institution that financed the Louisiana Purchase and served the royal family. After the bankruptcy of Barings, Leeson became an international celebrity. Serving jail time in Singapore, he wrote an autobiography (Leeson, 1996), which detailed his secret trading and the continual doubling down on his losses, actions

that destroyed Barings. The book was made into a movie in 1999, further adding to Leeson's fame.

In summary, given the pervasive 'no fault culture' in the USA, we suggest that it is safe to eliminate shame as a possible deterrent to unlawful behaviour. We turn next to the possibility that more expansive regulatory oversight could serve to raise the bar for ethical behaviour within the financial industry.

### **3 Expanded regulatory framework**

#### *3.1 Regulatory capture*

The financial crisis may be viewed as having been brought on by regulatory capture. However, in this case, the private rating agencies have been captured by the large financial institutions on which the continued viability of their businesses depends. To deal with this problem, it will be necessary to break the conflict of interest and make the rating agencies independent of financial institutions. One option is for private rating agencies to be replaced by a government agency that rates mortgages; the employees of the agency would be licensed professionals bound by a professional code of ethics and professional standards of conduct. An example of this approach is the FDA which hires scientists, chemists, and other professionals to carry out its work of screening drugs to make sure they are safe before approving them for use by the general public. Another approach being considered in connection with President Obama's overhaul of the regulatory structure for the financial industry is to have issuers of asset- and mortgage-backed securities subjected to 'robust' reporting requirements on the assumption that this will make investors and regulators less reliant on rating agencies. These issuers would report to a newly created Consumer Financial Protection Agency (Allen and Javers, 2009).

The classic work on regulatory capture is Marver Bernstein's (1955) *Regulating Business by Independent Commission*. Bernstein describes how and why regulation of business is necessary. The argument is relatively simple. Essentially, businesses cannot be trusted to regulate themselves; it is like the fox guarding the henhouse. Some outside watchdog is needed to make sure that all firms play by the rules, do not make decisions that result in short-term gains at the expense of the public, and do not engage in illegal or unethical practices. Although necessary from a public perspective, these regulatory commissions are generally opposed by firms in the industry. One reason they are opposed is that no one likes to be told what to do. But more important, government regulation generally means lower profits for firms, at least in the short term. In the long term, being regulated may enhance the reputation of firms within the regulated industry, leading to greater sales or higher quality products. Alas, too many firms tend to think short term rather than long term.

What Bernstein describes in his book is the process by which independent commissions get captured by the industry that they are supposed to be regulating. He identifies several reasons why regulation has been ineffective and the regulators captured by the industry they are supposed to monitor. First, he notes a general conservative and laissez-faire bias on the part of the US public. This means that regulatory commissions generally operate in an environment that is hostile to them performing their duties, and in an environment that is not conducive to any agency suggestions that things be done in a

new way. Consequently, regulations are promulgated with the goal of interfering as little as possible with business activity. It is assumed that the market generally, if not always, knows best. Additionally, the Office of Management and Budget (OMB) is an important constraint on regulatory zealotry; it is situated in the Executive Office of the President. A wide-ranging report titled, 'Centralized oversight of the regulatory state', describes the watchdog role of the OMB as follows:

“Born out of a Reagan-era desire to minimize regulatory costs, and not fundamentally reconsidered since its inception, the centralized review of agency rule makings has arguably become the most important institutional feature of the regulatory state. Yet it is a puzzling feature: although centralized review is sometimes justified on the ground it could harmonize the uncoordinated sprawl of the federal bureaucracy, the agency tasked with regulatory review, the Office of Management and Budget (OMB), has never embraced that role. It has instead doggedly clung to its original cost-reduction mission, justifying its function as a check on the federal bureaucracy with reference to the pervasive belief that agencies will systematically overregulate.” (Bagley and Revesz, 2006)

Second, there is competition among governments for less and less regulatory oversight. Originally it was individual state and local governments that regulated US firms. However, this has a number of disadvantages. States and localities need and want business firms to operate within their borders – generating jobs and tax revenues. So, it is easy for states and localities to 'compete' against each other with lax regulations to try to attract businesses. However, when it comes to selecting a state of incorporation, Delaware has enjoyed a monopoly for a number of years because it allows corporations a great deal of flexibility in constructing their corporate governance systems. Indeed, it is accepted knowledge that if firms decide to incorporate outside of their home state, Delaware is the only state which they consider [Alexis, (2009), p.219].

Another shortcoming of state-level regulation is the fact that states have fewer resources and fewer trained professionals to monitor business firms. As a result, regulation has moved to the federal level. And, federal laws like the Sarbanes-Oxley Act of 2002 (SARBOX) that have a pre-emptive effect in the area of corporate governance – long the bailiwick of a firm's state of incorporation – are accelerating the move to federal-level regulation (Alexis, 2009). But Bernstein notes that regulation at the federal level has also been ineffective. And the ineffectiveness has grown in the present global environment as nations now compete against each other to attract businesses as a source of foreign direct investment (FDI).

Third, there is the political power and influence of financial interests. They can influence who gets put on regulatory commissions. They can influence the budgets that the regulatory agencies receive and thus their ability to monitor firms. They can also lobby Congress and advertise to the general public against what they believe is excessive regulation. A case in point is opposition being mounted to forestall President Obama's plan for a tougher regulatory framework. Major corporations such as Caterpillar, Boeing Co., 3M Co., MillerCoors LLC., Bayer, and Delta Airlines are pushing back on the regulatory overhaul because they feel it is unfair for non-financial companies to "be put in the same boat as Wall Street speculators" [Scannell, (2009), p.B1]. Additionally, the regulated group attempts to get 'sound people' appointed to the regulatory commission, which means people who are sympathetic to the industry.

Auto manufacturers benefited from this strategy during the George W. Bush Administration. Because Bush appointed pro-business heads of the Environmental Protection Agency (EPA) during his eight years as President, the EPA stonewalled on implementing fuel emission control standards. Eventually twelve states, three cities, and three nongovernmental organisations (NGOs) filed suit against the EPA and in 2007, the US Supreme Court ruled that the Clean Air Act did indeed authorise the EPA to enact fuel emissions control standards to combat global warming (*Mass. vs. EPA*, 2007). Nevertheless the EPA continued to drag its feet, taking only perfunctory action and accomplishing nothing in terms of adopting fuel emission standards throughout the remainder of the Bush Term. It is only with the Obama Administration and the appointment of a new head of the EPA that action is being taken to adopt fuel emissions standards (Suarez, 2009).

Fourth, there is a false belief that regulation is not political and that the issues are just technical and economic. Regulation is viewed as just finding out the facts and then making decisions in an unbiased manner [Bernstein, (1955), Ch. 2]. Finally, Bernstein (1955, p.26) notes that regulatory agencies usually do not get funded adequately. Therefore, they cannot hire and keep people with the requisite expertise and so regulators will also lack the necessary experience. For these reasons, battles over regulation tend to get fought in the courts, which also lack expertise and experience in regulating business firms. The end result is that regulators become passive and pawns of the regulated industry.

To summarise, as was the case with engendering shame, expanded regulatory oversight alone will not bring about moral rehabilitation within the financial industry. Certainly, regulation is necessary; ‘integrity is a collective good’ that benefits everyone (Pressman, 2010). One need only look to the effect that the Federal Reserve and the FDIC had on the banking system. People went from putting money under their mattresses to depositing their money in local banks, thereby providing a source of capital for business and contributing to overall economic growth. So, it can be said that regulation is necessary, but not sufficient. In speaking generally about regulatory commissions, Bernstein (1955, 14f) notes that commissions are helped by an environment stressing the concepts of checks and balances and separation of powers. He notes that they are also helped by crisis, which compels a government to act. We see this in the establishment of the SEC after a large number of financial frauds came to light during the Depression. And, more recently, we saw the authority of the SEC enhanced by the Sarbanes-Oxley Act of 2002 (SARBOX) in the wake of the corporate accounting scandals at the dawn of this millennium. In fact, SARBOX implements just the types of checks and balances that Bernstein mentions as creating a friendly environment for regulatory commissions. In the next section, we shall take a closer look at SARBOX and its attempt to conscript in-house professionals as a check on corporate wrongdoing.

## **4 In-house professionals as internal watchdogs**

### *4.1 SARBOX and the conscription of in-house professionals*

Although increasing corporate transparency and corporate accountability are the main objectives of SARBOX, the statute additionally instructs the US Sentencing Commission to revisit the sentencing guidelines applicable to persons who commit securities and

accounting fraud to ascertain that the penalties are sufficient to deter and punish criminal fraud. Focusing particularly on white collar crime by corporate officers and directors, Section 1104(a)(2) of SARBOX directs the US Sentencing Commission to:

“...expeditiously consider the promulgation of new sentencing guidelines or amendments to existing sentencing guidelines to provide an enhancement for officers or directors of publicly traded corporations who commit fraud and related offenses.”

Nevertheless, it needs to be noted that criminal justice literature refutes any notion that either imposition of penalties or punishment serve to significantly deter criminal activity. For example, Banner (2002) reviews a large body of literature and concludes that there is no consensus on whether the death penalty reduces homicides. Going even further, DeLulio (1996, p.17) castigates economic models that assume poor urban youth are as rational as professors of economics, and notes when it comes to the economics of crime: “The reality simply does not fit the theory: economists need a new theory”.

Despite all empirical data to the contrary, the standard economic analysis of crime follows along the lines originally set forth by Jeremy Bentham and then developed by Nobel Prize winning economist Gary Becker. People are seen as making rational decisions about whether to engage in crime or to work in order to earn money. They compare the benefits and costs of each and then decide on the option with the highest net gain. The benefits are all the financial gains as a result of the crime. The costs involve possible losses from getting caught and from spending time in jail (Pressman, 2006).

SARBOX falls in line with the rational-criminal approach to deterring criminal activity. This approach results in policy proposals that

- a increase the risk of getting caught when engaging in criminal activity (SARBOX accomplishes this by making whistle-blowing mandatory for in-house attorneys and accountants)
- b impose harsh penalties if convicted such as more jail time and stiffer fines, exemplified by the SARBOX-mandated enhancements of fines and penalties for white collar crime.

Nonetheless, it will not be easy to conscript in-house professionals to the task of carrying out the SEC enforcement agenda given that their personal success is inextricably bound up with the success of their corporate employer. Sociologist Niklas Luhmann’s theory of systems differentiation offers a sound explanation of why this is so and it is taken up next.

#### *4.2 Luhmann’s systems differentiation*

“We can conceive of system differentiation as a replication, within a system, of the difference between a system and its environment. In differentiated systems, as a result, we find two kinds of environment: the external environment common to all subsystems and a separate internal environment for each subsystem.” Niklas Luhmann (1982, pp.231–232)

Niklas Luhmann posits society as a social system; namely, the main social system from which various subsystems differentiate themselves (Luhmann, 1997). What type of differentiation? It is useful to look at the USA situation. US society constitutes an external environment of secularism and capitalism; it functions on the basis of

legal-rational action. Yet, the family subsystem is not characterised by legal-rational action; rather its *modus operandi* is one of compassion and caring [Nelson, (1996), p.60]. Another illustrative example is the regulatory subsystem. Despite existing in a market-driven external environment, the regulatory subsystem adopts regulations to implement antitrust laws designed to curtail the predatory capitalist practices fermenting in its external environment. Viewed from a different perspective, a subsystem can be seen as delineated by the boundaries that close it off from the overall system and that make it a distinct and separate subsystem from the other subsystems. These boundaries hamper communication between the various subsystems. As an example, judges (judiciary subsystem) do not speak the same language as priests (religion subsystem).

Luhmann viewed both the social system and its subsystems as systems of communication. However, it is important to note that each subsystem is a self-contained unit and communication within that subunit takes place with only limited input from its external environment. Indeed, each subsystem is self-referential and uses its communication to constantly reinforce its own identity – to do otherwise would cause it to dissolve back into the greater society or possibly to be swallowed up by another subsystem. Systems theory is a useful analytical tool for understanding what happens to professionals who become corporate employees and enter into the corporate subsystem where communication is focused on economic success and where financial statements are the means of communicating economic success and financial statements do not take account of ethical lapses.

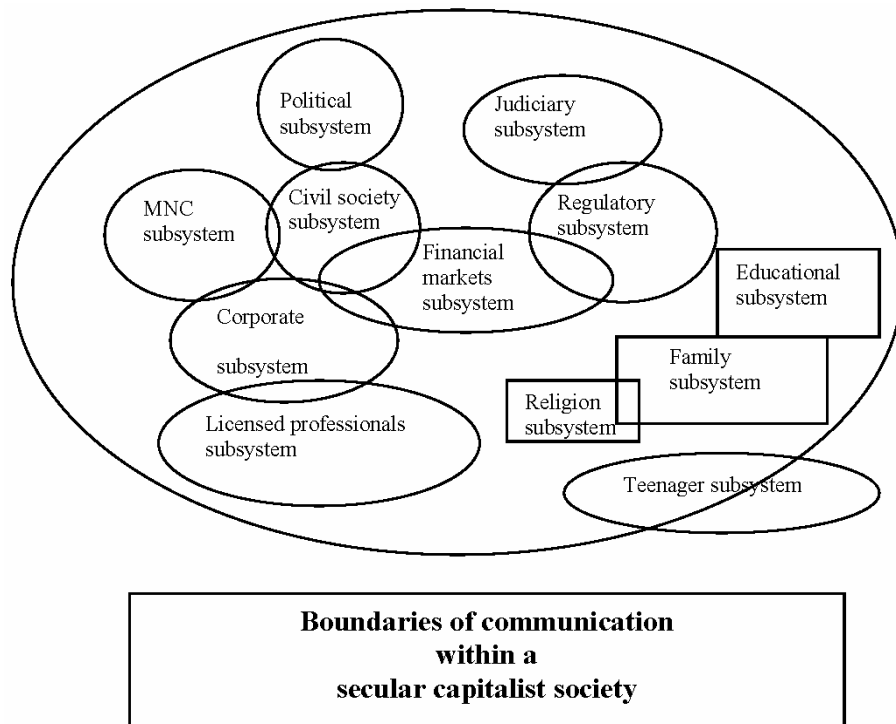
Reinforcement of self-identity is accomplished by filtering out communications (information) not deemed relevant. *Autopoiesis* (self-creation) is the term Luhmann utilises to describe the process of a subsystem reproducing its self-identity by discriminately filtering and processing information from its external environment. *Autopoietic closure* is when a subsystem is functioning in accordance with its own paradigm and screening out the paradigms of other subsystems as both incomprehensible and of no interest. In a subsystem that is all about income projections and profit and loss statements – as is the case in the corporate subsystem – in-house accountants and attorneys will be speaking a different language when they bring up professional ethics and corporate moral codes. And yet, this is the language one would expect to hear bantered about in the professional entrepreneurs subsystem; however, the autonomy to establish the moral tenor of the workplace is lost when a professional becomes an employee.

“For all of the emphasis on analytical rigor in business schools today, another major recommendation of the [Ford and Carnegie] foundations’ reports from the 1950s -- that business become a true profession, with a code of conduct and an ideology about its role in society -- got far less traction.” Harvard Professor Rakesh Kurana (quoted in Holland, 2009)

Professor Kurana is alluding to the fact that declaring allegiance to a specific code of conduct in carrying out one’s lifework has long been emblematic of entering a profession. But, professionals in the corporate employ are expected to subscribe to the general business principle of maximising profits and minimising losses. Since the corporate employer values activities that lead to profit maximisation and loss containment, there is generally no incentive for employees to engage in philanthropic endeavours for the benefit of non-economic stakeholders. The corporate subsystem, more than any other subsystem, mirrors its external environment of late capitalism and a market-driven

economy. In keeping with this, the corporate workplace is bureaucratically managed with an organisational structure that ensures that all efforts are directed toward maximising shareholder value. Moreover, since expenditures for corporate social responsibility (CSR) activities will, at best, deliver distant rewards – such as enhanced goodwill – and will, at worst, result in immediate increased costs, there is a disincentive for the corporate employee whose bonus is based on short-term results to voluntarily engage in CSR activities. System differentiation is depicted in Figure 1 below:

**Figure 1** System differentiation



With the help of Luhmann’s theory of system differentiation, we have seen why professionals working in-house are unlikely prospects for staving off the greedy pursuit of profits at any cost by their corporate employers. We look next at the Fannie Mae case to see how well Luhmann’s theory holds up in the real world.

#### 4.3 The Fannie Mae case

Fannie Mae was chartered as a government-sponsored enterprise in 1968 by the US Congress, and operated as a private shareholder-owned company until its takeover by the US Government in 2008. It operates in the USA secondary mortgage market and under its congressional charter, the Secretary of the US Treasury is authorised to purchase up to \$2.25 billion of Fannie Mae securities. It is this implicit government guarantee to keep Fannie Mae afloat that allowed it to borrow money in the bond market at lower yields



than other private financial institutions despite the fact that it was dealing with the riskier secondary market.

With its government-backed monopoly of the bulk of the secondary market, Fannie Mae was a source of envy in the financial community. However, once traditional financial institutions hit upon a way to partake of *securitisation* (transforming an illiquid asset into a security such as was being done with the mortgage-backed securities discussed above), they could compete with Fannie Mae. This led to a market share drop for Fannie Mae which reacted by purchasing and guaranteeing increasing numbers of securities and loans of low credit quality. Then, it was just a matter of time before Fannie Mae began to rely on ‘creative accounting’ to keep its shareholders and the public in the dark about how close to the brink it had come.

#### 4.4 Creative accounting

“Richard Stawarz, Director for [Fannie Mae’s] Accounting and Audit, told OFHEO that in 2003, before controls were enhanced in compliance with the Sarbanes-Oxley Act, he was unaware of any requirement for either the reviewer or approver to understand the purpose of a journal entry or to verify that such an entry was valid.” Report of the Special Examination of Fannie Mae [OFHEO, (2006), p.28]

*Pace* Director Stawarz, professional responsibility is not a product of SARBOX. The reviewer of financial records has always had a professional duty to maintain a healthy dose of skepticism when engaged in the auditing task. As might be expected, the proffered excuse that SARBOX was the precursor of standards for internal auditors held little sway with the investigators looking into accounting irregularities at Fannie Mae. In fact, in a scathing report issued at the conclusion of its three-year investigation, the Office of Federal Housing Enterprise Oversight (OFHEO) made specific reference to the fact that the corporate charter of Fannie Mae “tied the conduct of internal auditors to professional standards” [OFHEO, (2006), p.187]. In addition to citing its own publication, “OFHEO Policy Guidance, *Minimum Safety and Soundness Requirements*”, as an important source of information with regard to the obligations of both internal and external auditors, the OFHEO report noted various sources that provide guidance to internal auditors and, notably, SARBOX was *not* among the listed sources:

“Auditing is performed in compliance with the Institute of Internal Auditors’ (International) *Standards for the Professional Practice of Internal Auditing* and, when appropriate, the American Institute of Certified Public Accountants’ *Generally Accepted Auditing Standards*. ... Auditors are expected to conduct themselves in compliance with the *Code of Conduct* of The Institute of Internal Auditors.” [OFHEO, (2006), p.188]

Eventually, Fannie Mae was forced to pay \$400 million to settle a lawsuit brought by the SEC *solely* on the basis of the failure of Fannie Mae auditors to adhere to generally accepted accounting principles (‘GAAP’) during the period 1998–2004 – a period during which Fannie Mae overstated its earnings by \$6 billion (SEC, 2006).

It is noteworthy that it was not the internal auditors who received bonuses based upon Fannie Mae showing a profit; rather it was the higher echelons of management, the executive officers. Nonetheless, in announcing the \$400 million settlement against Fannie Mae as an entity, SEC Chairman Christopher Cox stated that the SEC will also pursue the individuals who were responsible for the accounting violations that resulted in

inflated bonuses for top executives and also seek to reclaim the unjustified bonuses from the executives who received them (Hagerty, 2006). It is clear that the executives who received the bonuses based upon inflated earnings statements should be pursued by the SEC and be made to repay the sums, based upon the legal theory of unjust enrichment. However, one might question the fairness of the SEC pursuing the in-house accountants and auditors in the Fannie Mae case for their failure to uphold the standards of the accounting profession when they are corporate employees serving a corporate client who is in fact their employer.

It is this corporate employer who establishes workplace goals and procedures and who, undoubtedly, has in place a compensation and incentive system that rewards those who follow orders and punishes those who do not. In short, the performance of these in-house accountants is evaluated on the basis of their success in helping to achieve corporate goals – on the basis of their being ‘team players’. To hold in-house professionals such as accountants and attorneys accountable in the same fashion as the autonomous professional entrepreneur of yesteryear is to attribute to those professionals an independence of action in carrying out their professional duties that is rare today. The employee-professional of today succeeds by ‘fitting in’ and embracing the corporate culture of the organisation in which she works.

Another sociological theory, *role strain*, that is complementary to Luhmann’s theory, helps to explain why the internal auditors at Fannie Mae abandoned the professional standards they had taken an oath to uphold upon becoming members of the accountancy profession. Role strain occurs when a single status, such as accountant, results in a person having conflicting roles [Johnson, (1995), p.237]. Here the status of internal auditor (i.e., in-house accountant) results in the conflicting roles of ‘accounting employee’ and ‘accounting professional’. A corporation’s utilitarian objectives, such as profit maximisation, will often result in role strain for the in-house professional whose conduct is to be guided by deontological principles. Profit-maximisation is an economic goal and it is measured by means of financial statements. Fulfilment of one’s professional duty can only be measured indirectly; e.g., one has not lost a licence, been arrested, or sued for malpractice. Hence, it is unlikely that in-house professionals will be able to raise the bar for ethical conduct within a corporation with an amoral or immoral culture. Most likely, ethical professionals will leave the corrupt corporate environment or they will, as was the case with Enron professionals, stay and ‘learn to go with the flow’; or, put another way, ‘If you lie down with dogs, you get fleas’.

Of course, individuals always face choices regarding whether or not they should behave ethically; and ‘ethical and practical concerns can conflict’ (Pressman, 2010). One aspect of this decision is that people must have jobs in order to feed themselves and their families, as well as providing shelter and other amenities. Thus, we can expect that in this time of corporate cutbacks and lay-offs, those who have corporate jobs want to keep them. Unfortunately, this could mean that in-house professionals will be even less likely to ‘rock the boat’, meaning that they will be even more pliant and accommodating in the face of corporate greed. A compelling case for this position was made by economist and philosopher Vivian Walsh in *Scarcity and Evil*. In this work Walsh (1961) argues that in a world of scarcity, survival requires unethical behaviour, and he criticises philosophers for ignoring the impact of scarcity on human behaviour.

However, what if survival in the corporate environment called for ethical behaviour? What if corporations paid more than ‘lip service’ to the high-sounding creeds, mottos and missions statements that they have been adopting and prominently displaying on their

internet homepages since SARBOX made good corporate governance their watchword and compliance – as in ethics and compliance officer – a growth industry? In the final section of this paper, we examine the emergence of corporate moral obligation (CMO) in response to the challenges that multinational corporations are facing in the global economy in order to see what hope this approach holds in terms of bringing about a moral renaissance within the financial industry.

## 5 Corporate moral obligation

### Caterpillar's Worldwide Code of Conduct

“Our Worldwide Code of Conduct, first published in 1974, defines what we stand for and believe in, documenting the uncompromisingly high ethical standards our company has upheld since its founding in 1925. This web site helps Caterpillar employees put the values and principles expressed in our Code of Conduct into action every day by providing detailed guidance on the behaviors and actions that support our values of Integrity, Excellence, Teamwork, and Commitment.” (Caterpillar, 2009)

Caterpillar maintains manufacturing facilities for over 300 products in 23 different countries. Thus, Caterpillar has ample opportunity to exploit a low-cost labour force in one of its foreign locales or to operate a plant that pollutes the environment in some less developed country (LDC). Such cost-cutting measures could be justified in that they would help maximise profits, benefiting economic stakeholders such as Caterpillar's shareholders, employees, and suppliers. Moreover, many of the less-developed nations (LDCs) where Caterpillar operates have national policy agendas that prioritise economic growth over all else, meaning that they relish the competitive edge that a low-cost labour force and lenient environmental laws gives them in attracting FDI (Baker, 2009). Hence, if Caterpillar followed a stakeholder approach to CSR, it could justifiably endorse more lenient codes of conduct and operating principles in LDCs.

However, as the opening quote reveals, Caterpillar has elected to adopt a ‘Worldwide Code of Conduct’ for its employees. This is in line with an emerging trend toward global codes of conduct among MNCs [Carroll and Buchholtz, (2009), pp.434–35]. There are two major concerns motivating MNCs to adopt uniform codes of conduct for their employees. First, the failure of an MNC to project a consistent corporate image at home and abroad makes it ‘fresh meat’ for the transnational NGOs who police the global marketplace enforcing what might be viewed as a ‘common morality’ that transcends geopolitical borders (Alexis, 2008a).

Functioning as a global civil society, these transnational activists for human rights, fair labour practices, and environmental stewardship serve to deter MNCs from displaying divergent standards of morality, dependent upon the locale in which they are operating. In these days of technology-enhanced communication, an MNC's reputation can be as easily tarnished by its malfeasance against workers or the environment at an offshore plant as it would be demeaned by the firm engaging in unfair labour practices or environmental pollution here at home (Alexis, 2007). And, transnational NGOs have recently added a new weapon to their arsenal; namely, filing a lawsuit under the Alien Tort Claims Act (ATCA). ATCA makes it possible to sue an MNC in a US District Court for human rights violations committed anywhere in the world (Filártiga, 1980). A number of prominent MNCs, including financial institutions – e.g., Citigroup, Credit Suisse

Group, Commerzbank, J.P. Morgan Chase, IBM, Unocal, Coca-Cola, Nestlé, and Liz Claiborne – have been named as defendants in ATCA lawsuits charging misdeeds ranging from equipping and financing the South African apartheid government’s military and security agencies to maintaining sweatshop labour plants on the island of Saipan.

The second motivation for an MNC to have a uniform code of conduct in place is that this decreases the likelihood that the unlawful acts of a corporate employee will be imputed to the firm. The US Sentencing Guidelines provide for more lenient sentences where a corporation has an ethics and compliance program in place (US Sentencing Guidelines §C2.5[f], 2007). And, easy access to this safe harbour is granted by §8B.2.1 of the Guidelines which specifies what a model ethics and compliance program should contain. Having this type of unequivocal statement of a firm’s ethical standards in place and, additionally, providing employees with compliance training serves to refute any assumption that an errant employee is engaging in unlawful acts at the firm’s behest. In other words, it rebuts the troublesome legal concept of *respondeat superior* under which an employer/employee relationship is deemed to be tantamount to a principal/agent relationship.

“The preventive-fault model of criminal culpability finds liability when a corporation fails to insert and implement an adequate internal system of controls to prevent the commission of a crime... This model of culpability is found in the U.S. Sentencing Guidelines. Under this model, the implementation of an effective compliance and ethics program by a corporation acts not only as a mitigating factor in determining the fine assessed to a corporate offender; it also represents a strong incentive for monitoring corporate policies and for modeling a law abiding corporate ethos. In the United States, the existence of an effective compliance and ethics program has become virtually prerequisite to avoiding a finding of corporate negligence.” [De Maglie, (2005), p.559]

Being held vicariously liable for the unlawful acts of a corporate employee can result in heavy fines being imposed on the employing corporation and where the corporation is a publicly traded company listed on a US Stock Exchange – generally the case with MNCs – it can result in delisting of the company’s stock!

Given that the stakes are so high for MNCs operating in the global marketplace, it is not surprising that MNCs like Caterpillar are adopting worldwide codes of conduct that incorporate ‘uncompromisingly high ethical standards’. Although a stakeholder approach to CSR has been widely adopted on the domestic scene, it is not a viable approach in the international arena where transnational NGOs are hammering out a global consensus on certain moral benchmarks and enforcing that consensus by mobilising public outrage when an MNC is found not to be living up to commonly agreed upon standards for ethical corporate behaviour. MNCs such as Nike (child-labour sweatshops), Chevron (environmental degradation in its offshore locales), Coca-Cola (environmental degradation in India and complicity in the murder of union organisers in its Columbian bottling plants), and Shell Oil (financing the Nigerian Government’s violent quashing of protests against Shell’s environmental rape of the Niger Delta in Nigeria) have felt the sting of adverse world opinion in their financial statements as all have had to take note of material impairments to goodwill as a result of widespread public outrage at their dastardly deeds abroad.

In short, MNCs are taking CSR to the next level by making a personalised commitment to those values that are deemed to be essential to fulfilling the corporate mission. *CMO* seems to us to be a fitting name for this emerging phenomenon of an

individualised corporate commitment. The beauty of CMO is the universality of its claim; it offers one map, one direction. For today's MNC, there is no other choice. Transnational NGOs and an aggressive world media mean that no stone can be left unturned in implementing doctrinal guideposts to steer the *entire* corporate enterprise; far too many maps are offered by stakeholder theory (Alexis, 2008b). In contrast to CSR, which speaks of place – the responsibilities owed to the societal stakeholders in a particular locale – CMO is self-referential. CMO is inner-directed in that it is concerned with a corporation's mission and the inculcation of values that are consistent with that mission. Hence, the reference point for CMO is the corporation itself, not the society within which a corporation finds itself.

The MNC that embraces CMO marches to the beat of its own drummer. For organisations caught up in the sullied reputation of the financial industry, CMO offers hope. There is no need to wait around for the new super regulatory agency that President Obama has promised to create to restore faith in the financial industry. Corporations can restore consumer and investor confidence in their organisations by building up trust themselves. They can start by declaring CMO to be their marching orders from here on out. This involves becoming familiar with the mission statements and corporate creeds that are meant to implement the corporate vision. These declarations should be more than colourful slogans used to fill up the space next to the corporate logo on the corporation's homepage. In order to project a consistent corporate image of honesty and trustworthiness, a corporation must cultivate and nurture behaviours among its employees that are consistent with the values being proclaimed. This means evaluation of employee performance must reflect the importance of ethical behaviour in achieving the corporation's financial goals. In this vein, unless the measurement of corporate performance entails measuring more than a corporation's economic goals, the claim that employee ethics is important will ring hollow. For the corporation that is serious about CMO, the bottom line is not about value, it is about values.

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