

Pies, Ingo; Hielscher, Stefan

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Fighting corruption: How binding commitments of business firms can help to activate the self-regulating forces of competitive markets

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Ingo Pies und Stefan Hielscher

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Diskussionspapier Nr. 2019-04

des Lehrstuhls für Wirtschaftsethik
an der Martin-Luther-Universität Halle-Wittenberg,
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Autoranschrift

Prof. Dr. Ingo Pies
Martin-Luther-Universität Halle-Wittenberg
Juristische und Wirtschaftswissenschaftliche Fakultät
Wirtschaftswissenschaftlicher Bereich
Lehrstuhl für Wirtschaftsethik
Große Steinstraße 73
D-06108 Halle
Tel.: +49 (0) 345 55-23420
Fax: +49 (0) 345 55 27385
Email: ingo.pies@wiwi.uni-halle.de

Dr. Stefan Hielscher
Prize Fellow Business & Society
University of Bath, School of Management
Centre for Business, Organisations & Society (CBOS)
Clayerton Down Rd
BA2 7AY
Tel. +49 (0) 1225 385839
Email: S.Hielscher@bath.ac.uk

Korrespondenzanschrift

Prof. Dr. Ingo Pies
Martin-Luther-Universität Halle-Wittenberg
Juristische und Wirtschaftswissenschaftliche Fakultät
Wirtschaftswissenschaftlicher Bereich
Lehrstuhl für Wirtschaftsethik
Große Steinstraße 73
D-06108 Halle
Tel.: +49 (0) 345 55-23420
Fax: +49 (0) 345 55 27385
Email: ingo.pies@wiwi.uni-halle.de

Kurzfassung

Korruption ist eine ernste und komplexe Herausforderung für moderne Gesellschaften. Korruptionsprävention erfordert daher konstruktive Lernprozesse. In diesem Beitrag wird ein ordonomisches Orientierungsangebot entwickelt, das die Wirtschafts- und Unternehmensethik systematisch miteinander in Verbindung bringt. Unser zweigeteiltes Argument lautet wie folgt: Erstens kann aus wirtschaftsethischer Sicht gezeigt werden, dass Korruptionsprävention im Sinne einer kollektiven Selbstregulierung nicht gegen Unternehmen in Stellung gebracht werden muss, sondern in ihrem eigenen Interesse liegend ausgewiesen werden kann. Der Grund hierfür liegt in der Erkenntnis, dass der Korruptionswettbewerb eine kollektive Selbstschädigung für alle beteiligten Unternehmen darstellt. Zweitens kann aus unternehmensethischer Perspektive argumentiert werden, dass Whistle-Blowing Systeme interne Schweigekartelle aufzulösen in der Lage sind, welche ein wichtiges Hindernis für die Etablierung eines wirksamen Integritätsmanagements darstellen.

Schlüsselbegriffe: Korruption, Korruptionsprävention, Governance, Selbstbindungen, soziale Dilemmata, Integritätsmanagement

Abstract

Corruption is a serious and complex challenge for modern societies. Fighting and preventing corruption thus requires constructive learning processes. In this paper, we systematically integrate a market ethics perspective with a business ethics perspective constitutive for the study of “ordonomics”. In doing so, we argue that, first, companies have a(n) (common) interest in actively fighting corruption using collective forms of self-regulation and, second, we show what companies can do about it internally. We derive the first argument from a market ethics perspective that shows how companies suffer from a race to the bottom that results from corruption under market competition. The second argument is based on a business ethics perspective that shows how cartels of silence within companies can create significant obstacles for well-meaning top management to address the problem effectively.

Keywords: Corruption, prevention of corruption, governance, commitments, social dilemmas, integrity management

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Fighting corruption: How binding commitments of business firms can help to activate the self-regulating forces of competitive markets

Ingo Pies and Stefan Hielscher

Introduction

Corruption is a serious problem that leads to a double erosion of trust—in and within the system of the market economy. Corruption endangers economic prosperity, political democracy and social development. But corruption also hampers productive value creation in markets when misallocation leads to massive material damage, destroys personal relationships of trust and undermines standards of personal and organisational integrity.

But corruption is also a complex problem. However desirable the fight against corruption may be, preventing it is not a simple task. It poses great challenges to society, companies, but also political actors and civil society organisations. Fighting corruption requires comprehensive learning processes on two levels: on the level of institutions—the social structure—and on level of ideas—semantics. An effective fight against corruption requires the development of functional commitments—rule reforms that address the challenges of social dilemmas. But functional rule reforms do not naturally fall from the sky. They are closely linked to the intellectual concepts and thought categories actors use to describe the problem of corruption and evaluate possible solutions.¹

This paper summarises an argument for how to analyse and address the societal challenge of corruption with and within companies. In doing so, we systematically integrate a market ethics perspective with a business ethics perspective which is constitutive for the study of “ordonomics” (Pies et al. 2009, 2010, 2014; Hielscher et al. 2014). It is essential to integrate these two perspectives, first, to understand whether companies have an interest in actively fighting corruption (market ethics perspective) and, second, if there is such an interest, what companies can do about it internally (business ethics perspective).

The paper proceeds in three steps: First, we describe some fundamental problems and challenges of corruption (and the fight against it). Second, we take a market ethics perspective to argue that companies have a common interest to overcome the race to the bottom that results from corruption under market competition. Third, we take a business ethics perspective to show how companies can address and overcome cartels of silence which often are a significant obstacle for well-meaning top management to generate knowledge and solve the problem. We finish with three summarizing propositions.

A final note about the arguments presented in this short paper: a variegated set of talented scholars have dedicated many years to study the problem of corruption at the Chair of Economic Ethics at the Martin-Luther-University Halle-Wittenberg, Germany. Their research forms the basis of what we present in this paper, including Pies (2002), Pies and Sass (2005) and (2008), Pies (2009), von Meyer zu Schwabedissen (2008), as well as Pies and Beckmann (2009). None of these valuable insights, however, have made

¹ In this paper, we will focus primarily on the institutional challenges and prospects of fighting corruption. For a more detailed analysis of the semantics of corruption, cf. Pies and Beckmann (2009).

their way into the international discussion of business ethics. This paper is the first attempt to present these arguments to a broader audience.

1. Some fundamental aspects of corruption

Before we take a market and business ethics perspective to illuminate the challenge of corruption, let us first take a quick look into the practical phenomenon. What is corruption and why is it a problem? Why is it so difficult to detect? And why do governments and the legal system struggle to address it with the usual means of criminal law and other forms of regulation? This first section provides a sketch of answers to these questions.

1.1 Two types of corruption: Burdensome versus unburdening corruption

There are two types of corruption. The first is akin to blackmailing. In such a situation, a transaction partner exploits a position of power to extort special services from the other side of the transaction. Since such claims represent an additional cost in the transaction, we will refer to this as “burdensome corruption.” Type-1 corruption is widespread in developing countries. In turn, type-2 corruption dominates in industrialized countries such as the UK or Germany. In contrast to type-1 corruption, the transaction partners perceive type-2 corruption as a mutually advantageous exchange, which goes at the expense of some non-involved third party. Because type-2 corruption removes an obstacle that would otherwise impede the transaction, we will refer to it as “unburdening corruption.” Unburdening corruption is always associated with a breach of trust, because one side of the transaction abuses an agency relationship to generate illegal income.

Typical examples of burdensome corruption are

- facilitation payments at the airport extorted with the threat to be held off arbitrarily at the customs,
- forced tips for a traffic police officer to prevent unjustified harassment during traffic controls, or
- bribes paid to a public service official to prevent unnecessary delays when applying for a car permit.

Typical examples of unburdening corruption are

- bribes paid at the airport customs to smuggle illegal goods,
- the "tip" to have the traffic police officer turn a blind eye to a clear-cut traffic offence, or
- bribing a civil servant for a permit for which one is not qualified.

In general, burdensome corruption occurs mainly in the state sector while unburdening corruption also occurs in transactions between the state and the private sector, and within the private sector. A clear-cut example of unburdening corruption in the private sector is when a company bribes its client's procurement manager to win a profitable contract that would not be awarded in a fair, competitive bidding process. Unburdening corruption allows acquiring a competitive advantage that is both illegitimate and illegal.

Both types of corruption are socially harmful, albeit for different reasons. Burdensome corruption acts like a distorting tax that negatively affects the process of allocation in markets. Unburdening corruption, in contrast, undermines the market principle of the division of labour, which systematically depends on the integrity of contractual performance relationships between employers and employees. Here, too, the efficient economic allocation of resources is severely impaired.

However, there is also an important difference between type-1 and type-2 corruption. In the case of burdensome corruption, the perpetrator is forced to pay a bribe although he would rather like to avoid corruption, e.g. by reporting the incident to superiors or the police. This is the major reason why type-1 corruption requires large parts of the state apparatus to be involved in order to cover up a wide-spread corruptive practice. This is often the case in developing countries, especially when governments use bribe payments to supplement the poor salaries of underpaid civil servants. In the case of unburdening corruption, however, the perpetrator wishfully pays bribes to gain an unlawful advantage. Here, there is no conflict but a harmony of interests between the active and the passive sides of corruption. Type-2 corruption can be initiated by both sides. Type-1 corruption, in contrast, is always initiated by the beneficiary.

In the following, we will exclusively speak to unburdening corruption. Preventing corruption thus requires to break up a criminal harmony of interests. Numerous effects must be taken into consideration here, which may seem rather counter-intuitive. We therefore develop the argument step by step.

1.2 Unburdening corruption: the problem

If one focuses exclusively on the actors directly involved in unburdening corruption – i.e. the passively bribed agent and the actively bribing client – it is difficult to distinguish an act of corruption from an act of market exchange (Fig. 1a). The reason is that the bribe and the return service – the quid pro quo – are linked in such a way that both parties hope to gain an advantage.

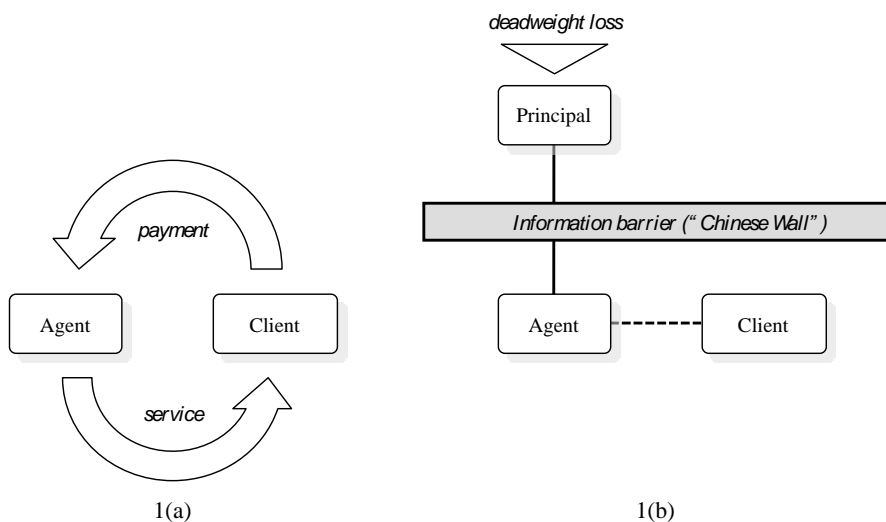


Figure 1a and b: Corruption as mutually beneficial market exchange or as a dead-weight loss to society?

To appreciate the difference between corruption and market exchange we need to broaden our perspective. Consider that the agent finds itself in a principal-agent relationship that mandates to act according to the interests of a principal (Fig. 1b). If the agent causes uncompensated costs for the principal, she abuses the principal's trust and betrays his interests. This is the reason why corruption is a deadweight loss for society.

Corruption makes agent and client better off. Their mutually beneficial cooperation, however, goes at the expense of a third party, the principal. The principal, in turn, cannot defend against it, since he lacks access to the relevant information. Even worse, agent and client try to hide their corruptive practice—and the loss involved for the principal—by erecting an information barrier between them and the principal. They can do so in different ways. Agent and client can manipulate tenders before and after a public bidding procedure, conspire to exchange secret information, set up sham transactions, or establish and use slush funds to inconspicuously transfer illegal payments.

In sum, corruption is a crime of secrecy. Appreciating that has far-reaching consequences. First, the information barrier protects the perpetrators' identity and anonymity. Second, targeted and thus costly controls are required to discover the criminal act. As a result, corruption that is taking place behind such an information barrier is akin to a smouldering fire without fire and smoke — it destroys values even if it goes unnoticed for quite some time.

1.3 Unburdening corruption: why government solutions often fail

There are attempts in numerous countries to use government regulation to protect the principal. Governments then use the legal apparatus of criminal law to sanction agents and clients individually (Fig. 3).

Using the criminal law is expected to have a preventive effect. But this is usually not the case. As an instrument of prevention, criminal law is a very blunt sword because the authorities are cursed with the same challenges as the principals, the invisible information barrier. As a result, authorities usually lack the initial suspicion that would allow starting a well-founded investigation. It is precisely the secrecy of agent and client that undermines the criminal reinforcement of their actions. The probability of detection is low.²

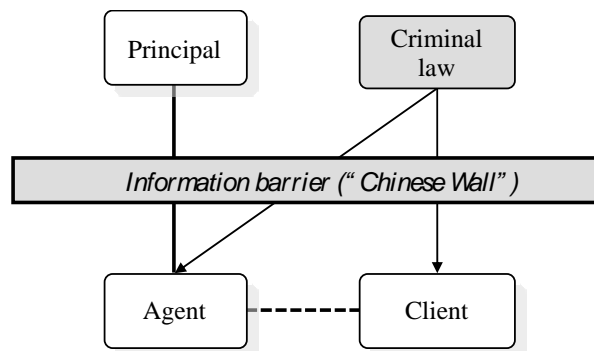


Figure 2: Corruption as a crime of secrecy

² Still, agent and client cannot rely on the legal system to support their transaction. So they need to find other means to create and maintain trust. Cf. Lambsdorff (2002a) und (2002b).

In principle, the low probability of detection could be (over)compensated by raising the penalties accordingly. But this is neither possible nor desirable. Under the rule of law in constitutional states there are typically good reasons to align the level of penalties in proportionality with the criminal act. This sets very narrow limits to the strategy of using criminal law to effectively prevent corruption. This type of first-order regulatory policy tends to run nowhere.

1.4 The fundamental asymmetry: principals versus owners

At first glance, it might appear that there is little hope of effectively tackling corruption. However, if we broaden our focus again, we can identify a fundamental asymmetry that serves as a suitable starting point for solving the problem (Fig. 3).

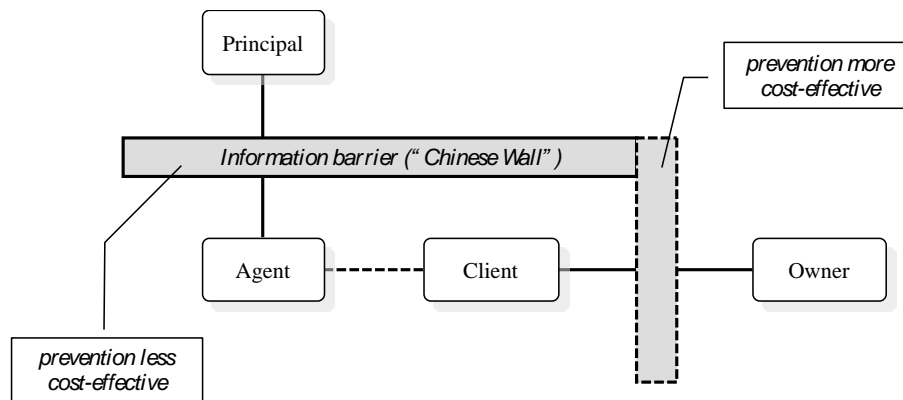


Figure 3: Corruption: The fundamental asymmetry

First, consider the agent. The corrupt agent accepts money, which flows directly into a private account but evades the principal's books. This is the reason why it is so difficult for the principal to break through the information barrier.

Second, consider the client. The client, who actively bribes, uses the financial resources of his company, not his own, to achieve an illegal competitive advantage for his organization. To do so, the client needs slush funds.

The client's company marks the crucial difference: The owner of the client's company in principle should find it much easier to get to the relevant information—and thus overcome the information barrier—because the client needs to establish an entire organizational infrastructure to set up and successfully operate slush funds. The principal who ultimately suffers the loss is in a much more difficult position. This is the *fundamental asymmetry* between the principal—the agent's contracting partner—and the owner—the client's employer.

At first glance, there doesn't seem to be much in for companies to prevent corruption. After all, the fundamental asymmetry just means that it is easier for the owners of the bribing company than for the principals of the bribed company to break through the information barrier and achieve the relevant information. One way to formulate the problem is this. At first sight, it may appear that the principals *want* to fight corruption but *cannot* do so, while the owners—due to the fundamental asymmetry—may be *able* to fight corruption (comparatively more easily) but do not really *want* to. After all, they are the (al-

leged) beneficiaries of corruption, because it is the owner's company that attains a competitive advantage when the client bribes an agent. Viewed in this light, persuading companies to engage in the fight against corruption is a lost cause. Such a strategy would be similar to putting the fox in charge of the henhouse.

However, as we aim to demonstrate in the following section (Section 2), an alternative perspective of market ethics is possible that highlights the interest for companies in preventing corruption. Then, and only then, can we hope to persuade companies to listen to the arguments of business ethicists to make use of the variegated anti-corruption toolkit—organizational missions, moral commitments, ethics codes and ombudspersons for whistle-blowing—in order to fight corruption within the organization (Section 3).

2. Market ethics: the common interests of companies to fight corruption and how to activate them

If one follows the widespread tendency in public discourses to explain corruption with vicious motives of organizations (and their managers), then companies inevitably appear as perpetrators that profit from corruption, exclusively. But is this the only way to diagnose the phenomenon? After all, we would have little chance of activating companies to fight corruption and instead should expect considerable resistance from companies.

2.1 Corruption as a race to the bottom

Fig. 4 paves the way for an alternative interpretation of the interests of companies to prevent corruption.

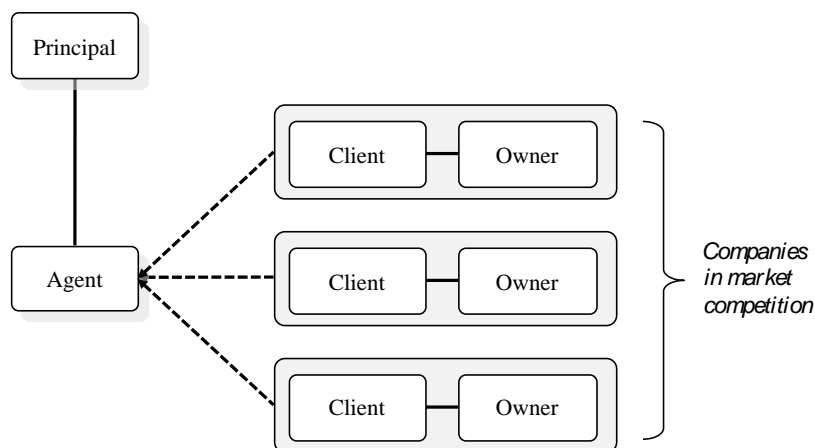


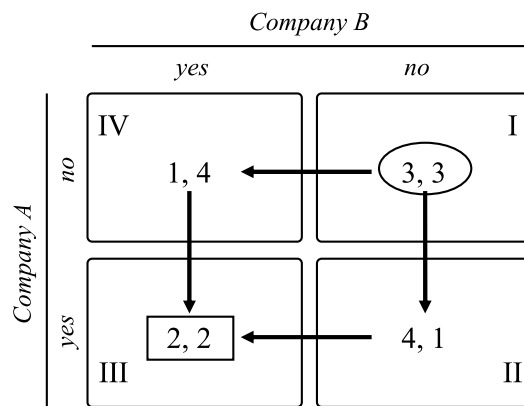
Figure 4: Corruption as a race to the bottom

On competitive markets, we need to assume that not only a single company, but also every competitor in the market will do everything in their power to survive in competition. The client's company, therefore, must not be viewed in isolation but instead as being embedded in a market of competing firms with similar interests. Once again, broadening our perspective allows an alternative explanation: companies find themselves faced with a dilemmatic race for corruption.

Such an economic reconstruction of the “game” of corruption takes the social interdependence of the logic of market competition seriously. The diagnosis is as follows: Rampant corruption in an industry is a non-intended result of interaction which is not only socially undesirable, but also represents a collective self-damage for the directly involved companies.

Figure 5 uses a payoff matrix to illustrate the logic of this dilemmatic race for corruption. In this representation, the line player A represents a company faced with the choice of whether to run the business without corruption or using bribes to receive orders. The column player B represents all other companies in the same industry that face the same calculus.

The arrows in Figure 6 reflect the rationale of both players: For Company A and Company B, it is rational to rely on the corruption strategy, regardless of the strategy chosen by the other company. Take the calculation of company A: If all other companies renounced any form of bribery, A could gain a competitive advantage over its competitors using a small favour ($4 > 3$). This is why the right arrow points down in quadrant II. Conversely, it would be detrimental for Company A to refrain from corruption if all other companies would engage in corruption. Here, the company's own corruption strategy is indispensable to protect against competitive disadvantages vis-à-vis the market competition ($2 > 1$). The left arrow points downwards in quadrant III.



Order of payoffs: $4 > 3 > 2 > 1$

Alternative: commit corruption?

Figure 5: The race of corruption as a social dilemma

Since the same considerations also apply to Company B, both players jointly realize quadrant III, in which all companies resort to corruption. So, what is it that companies hope to gain from using corruption? Our answer is this: From the point of view of the companies, which are in fierce competition with each other, the incentive for corruption ultimately consists in gaining a competitive advantage over their competitors (A aiming at quadrant II) or protecting themselves against individual competitive disadvantages, respectively (A avoiding quadrant IV). Corruption is attractive because (or if) it promises to create competitive advantages or to avoid competitive disadvantages.

Now, a crucial factor is to understand how the companies compare the quadrants I and III. Here, our economic reconstruction comes to a fundamentally different judgement than

the everyday perception presented in the beginning of the section. We argue that although the companies reach quadrant III as a group, they have no interest at all in realizing this result. On the contrary, in quadrant III the companies clearly realize—seen from their point of view!—an undesirable result. If all companies participate in the corruption race, there is ultimately no company left to realize a competitive advantage over competitors. Compared to quadrant I, quadrant III offers no advantage for the involved companies whatsoever. The possibly hoped-for benefit of corruption is lost entirely. At the same time, however, there are far-reaching disadvantages of corruption which put companies in quadrant III in a worse position than in quadrant I. First, there is the risk of corruption being revealed one day despite reinforced attempts to keep the secret. This risk involves legal and official sanctions, fines, a damage to the public's reputation and a loss of trust among important stakeholders. Second, corruption entails considerable costs for companies even if kept secret successfully. On the one hand, secrecy itself is costly. On the other, moral standards within the company erode. Also, we need to think of the often very expensive bribes companies pay—although in the corruption race many of them ultimately fail to reap the hoped-for benefits.

Our diagnosis suggests that companies do not benefit from but instead collectively damage each other in the race for corruption. Taken as a group, the involved companies would appear to have a common interest in avoiding the inefficient quadrant III and would rather realize the Pareto-superior quadrant I, thus saving the considerable costs of corruption. Of course, companies trapped in a swamp of corruption fail to actually realize their common interests. The reason is that the companies find themselves in a social dilemma—a rationality trap in which companies cannot achieve their common group interest due to the incentives that stem from their conflicting individual interests. Viewed this way, companies are not (only) perpetrators, but also the (partial) victims of corruption. They are corrupt because—as individual actors—they have no choice but to partake in what appears to be a race for corruption, even though, as a group, they would prefer not to play the game at all.³

2.2 Collective commitments to address the race of corruption

If companies find themselves in a many-sided social dilemma—as in the corruption race of Fig. 5—it is not sufficient that a single company changes its individual moves. Quite the contrary: if a company were to commit itself individually to renounce any corruption strategy, this commitment could be exploited by all other companies. This would not change the incentives of the competitors and so corruption would persist.

Instead, to address the corruption problem effectively, the incentives must be changed simultaneously and symmetrically for all players so that the involved companies can jointly realize the Pareto-superior result in quadrant I. This requires a collective commitment that binds all companies even-handedly so the corruption strategy loses its individual incentive for each player. In principle, a collective commitment can be organised in two ways, namely by third parties that enforce the commitment upon the players or a functional self-binding commitment of the involved companies themselves.

³ Empirical studies provide evidence that public knowledge of widespread corruption in a countries deters foreign direct investments. Cf. Lambsdorff (2006) and Pies and Sass (2008).

Third-party enforcement by government regulation plays an important role in combating corruption. Government regulation contributes a differentiated and powerful set of instruments for rule enforcement, from the police and other investigating authorities to public prosecutors, courts and sanctioning authorities. This way, the institutional framework defines sanctions for economic crimes and thus protects companies with integrity from being exploited by corrupt competitors in competition.

However important the legal framework may be for companies, the fact that corruption remains a serious problem, even in countries with the rule of law, shows that government regulation faces its limits. As discussed in the previous section, corruption is a crime of secrecy that goes at the expense of third parties, and so there often is no plaintiff since principals are often unaware of corruption. Another important aspect is that in many countries, although governments commit to preventing corruption in theory, the actual enforcement often remains incomplete in practice.

Against this background, an effective prevention of corruption requires to go beyond government regulation and to search for ways to interest companies in collective self-commitments to break the spiral of corruption.⁴ Two examples may suffice to illustrate how companies can do so.

- Perhaps the best-known forms of collective self-commitments of companies are Transparency International's integrity pacts.⁵ This instrument is used in bidding competitions for public contracts. An integrity pact binds the participating companies to refrain from making any illicit payments, during or after the public contract, and public authorities promise not to accept bribes. Integrity pacts also prohibit secret agreements between companies and civil servants. All involved parties commit to disclose all commissions or similar payments. If companies violate these commitments, they risk to lose the contract or a deposit, and they run the risk of being excluded from future public contracts.⁶ Transparency International's integrity pact is thus an example of how companies can address corruption by participating in the rule-making process and establishing suitable rule-enforcement mechanisms. When signing an integrity pact, companies can be more confident that competing companies will also act with integrity.
- The Extractive Industries Transparency Initiative (EITI) is another spectacular initiative to fight corruption and improve transparency in the extractive industries.⁷ Launched at the World Summit on Sustainable Development in Johannesburg in 2002, EITI aims to increase the transparency of money payments during the extraction of oil, gas and other raw materials and thereby enable civil society to control their whereabouts and uses. Companies participating in EITI commit themselves to implement the principle "publish what you pay" and publicly disclose which payments they make to which government authorities, and how high these payments are. Well-known companies of the petroleum industry such as BP, ExxonMobil, Shell and TOTAL, non-governmental organisations, investment funds, the World Bank and the International Monetary Fund actively support EITI in their

⁴ Cf. Meyer zu Schwabedissen (2008).

⁵ Cf. Pies and Sass (2005).

⁶ According to Transparency International, "Integrity Pacts ... have been applied in more than 15 countries and 300 separate situations. They help save taxpayer money, ensure that infrastructure projects and other public works are delivered efficiently, and close off avenues for illicit gain." Cf. https://www.transparency.org/whatwedo/tools/integrity_pacts/5.

⁷ Cf. Pies et al. (2009).

efforts to promote transparency and integrity standards ("good governance") in the producing countries and to counter the widespread corruption associated with the extraction of raw materials.⁸ At the same time, numerous governments support EITI politically, logistically and financially, including the home states of many multinational corporations such as Australia, Belgium, Germany, France, Great Britain, Italy, Canada, the Netherlands, Norway, Spain or the USA.⁹

3. Business ethics: how companies can fight corruption internally and become effective corporate citizens

The perspective of market ethics shows that companies have a common interest in the fight against corruption—and that collective self-commitments can help to overcome races of corruption. Even if we have now established an interest-based reason for companies to fight corruption, collective self-commitments can function only if companies bind themselves effectively to implement a credible and effective internal management system. For competitors, non-governmental organisations or state actors will only be prepared to cooperate in projects of collective self-regulation against corruption if companies do their homework and secure their organizational integrity with appropriate governance mechanisms.

3.1 Cartels of silence within corporations

A company is an actor faced with competition in markets. Internally, however, it is also an organization with a multitude of actors interacting with each other, including managers and employees. Thus, within the organization, corruption can be seen as a result of many-sided social dilemmas similar to the ones just analysed. Often, these social dilemmas lead to corruption within the company although they represent an undesirable and unintended result of interaction from a firm's point of view. For example, just as companies compete with each other, so too several departments within a company compete with each other, and within the departments several individual actors. Departments compete for budgets, managers and executives compete for bonuses, recognition and, in particular, career opportunities. Intra-company competition can provide important incentives to promote value creation. Without appropriate rules, however, it can also foster corruption. If a company lacks a professional integrity management and, at the same time, sets performance targets for its sales managers that are barely achievable legally, there is a danger that managers will run into a race for corruption, even if this is not intended by the company's top management. It is therefore important that performance incentives are designed in such a way that they promote honest behaviour, instead of punishing it.

In companies guilty of corruption, however, there are not only perpetrators and their accomplices but also confidants, i.e. actors that have not become criminal but accidentally become aware of the corrupt activities of their colleagues. This is an important starting point for an effective fight against corruption since, as we have argued in section 1, corruption suffers from being a crime of secrecy. In fact, corruption can only work if—and only for as long as—the accomplices can trust that any confidant keeps his silence. In

⁸ <https://eiti.org>.

⁹ <https://eiti.org/countries>.

some organizations, employees and managers form downright conspiracy cultures and cartels of silence. In fact, the scandals of recent years have provided some shocking insights. Sometimes, corruption had reached an extent that the circle of insiders included not dozens but hundreds of confidants.

How is it possible for such outrageous practices to occur in the first place, let alone remain on place for many years? From a business ethics perspective, we need to understand how formal and informal rules can discourage a culture of transparency and criticism. Many people find it unpleasant to criticize others, let alone to be criticized. If companies lack a professional management, within the organization a culture of silence will emerge and tend to persist. If employees need to fear individual disadvantages for revealing bad news, they will not bring unpopular rule violations to the attention of management. The confidants' silence then is an unintended result that supports corruption because perpetrators and accomplices are not held accountable.

Figure 6 models the interaction logic between a perpetrator (P) and a confidant (Conf). The perpetrator must decide whether he wants to engage in corruption. The confidant is faced with the choice of uncovering and reporting the offence. The payoffs can be explained as follows: Compared with the option to refrain from corruption (payoff 0), the "worst case" for P is to be reported to the management (payoff -1), while the "best case" is to go unreported (payoff 1). The situation for the confidant is different. We start with a scenario without corruption (payoff 0). In case an offence is committed but goes unreported by the confidant, then at least it will trigger pangs of conscience. These psychological costs of remorse amount to r , with a payoff of $0-r$. If, however, the crime is reported, the confidant must also reckon with costs (c). These costs result from the fact that he might be branded by others as a "traitor", as a "runner-down of his company", as someone who violates loyalty obligations. A confidant who discloses internal corruption risks a crisis of trust with his colleagues, which may expose the confidant to social isolation, moral disapproval, and ostracism. That is why the payoff here is $0-c$.

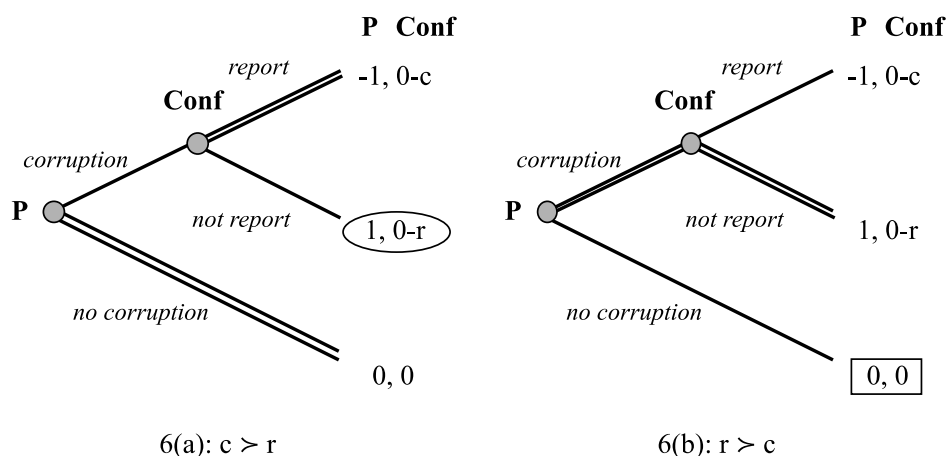


Figure 6: The impact of a public (6a) and an anonymous whistle-blowing system (6b) as an instrument to fight corruption within companies

Figure 6a models the case in which the costs of (feared) social ostracism more than outweigh the costs of remorse ($c > r$). Here, the confidant has an interest to remain silent. Perpetrators who anticipate this situation can take the risk of corruption. The equilibrium

in this game is the strategy combination with the payoffs (1, 0-r). This explains why there are cartels of silence in many companies.

Figure 6b shows the reverse case. Here the expected costs of social exclusion are lower than the costs of remorse ($r > c$). As a consequence, it is in the confidant's best interest to disclose the crime. Rational perpetrators will anticipate this and avoid the risk of corruption. The equilibrium of this game the strategy combination with the payoffs (0,0).

3.2 Commitments to overcome cartels of silence

How the company avoid the undesirable result (Figure 6a) and instead achieve much more desired result (Figure 6b)? How can companies dissolve the cartel of silence?

An important part of any answer to these questions are anonymous whistle-blowing systems.¹⁰ Whistle-blowing systems involve establishing an ombudsperson's office committed to discretion, to whom a confidant can turn as a whistle-blower without revealing one's identity. Having the choice to use an anonymous reporting procedure dramatically reduces the expected costs of disclosure (c) and thus increases the probability that confidants reveal their knowledge (because now $r > c$). This increases the risk costs of corrupt perpetrators, with a large preventive impact.¹¹

From a business ethics perspective, three aspects are important for whistle-blowing systems to reap their full potential of preventing corruption.

- First, job rotation or the four-eye principle for decision-making situations receptive for corruption can only unfold their preventive impact once a whistle-blowing system has been introduced. Since these instruments systematically aim at generating confidants, they are futile as long as confidants have incentives to remain silent.
- Second, whistle-blowing systems must be implemented with care. This requires complementary measures to keep the promise of anonymity in real-life situations. Without a credible commitment to anonymity—implemented by a trustworthy ombudsperson—the instrument cannot function properly. It is also important for the company—for example, by means of a code of conduct with sanctions—to communicate the expectation that this whistle-blowing should be used by employees to protect the company's integrity. Regular trainings can also help to raise awareness and to communicate to employees that corruption should not be regarded as a trivial offence. In this way, companies can stimulate and foster an innovation-friendly culture of critical loyalty. Whistle-blowing as an instrument must therefore be systemically embedded in procedures of organisational learning, through

¹⁰ Cf. Leisinger (2003).

¹¹ Empirical studies have shown the preventive impact of whistle-blowing systems. Bussmann and Wehrle (2006; p. 1135) argue: „Worldwide, companies with whistleblowing systems tend to have higher detection rates; however, it cannot be resolved whether this was due to the whistleblowing system or to a generally higher awareness in these companies (that motivated them to adopt whistleblowing systems). Whistleblowing systems had a different impact on the detection of different types of crime. They proved to be most effective for detecting corruption and bribery, but insignificant for money laundering and illicit insider trading. In Australia, whistleblowing systems were reported to have detected all cases of reported corruption compared with 50 per cent in India, 25 per cent in the United Kingdom and 25 per cent in the United States (global: 15 per cent).“

which the company as an organisation makes itself sensitive to the problem and ensures its own integrity.

- Third, a systematic management of social interactions is far more complex than it may seem. This applies equally to market ethics and business ethics. From a market ethics perspective, although a mutually beneficial cooperation often appears to be desirable, there are other forms of cooperation that are not supported but deliberately prevented. For example, the prohibition of cartels serves to reap the full benefits of social cooperation in competitive markets. The same usually applies to the promotion of trust from the point of view of business ethics. In general, trust is an indispensable prerequisite for successful value creation, which only results if the transacting partners honour their promises of *quid pro quo*. However, there are also forms of trust that to suppressed to reap the benefits of cooperation. In this sense, whistle-blowing serves to systematically incite *distrust*. Within the company, criminals should not be able to rely on confidants—with mistaken sense of loyalty—to conceal and cover up corrupt practices. Against this background, our business ethics perspective suggests a differentiated management of commitments that uses formal and informal incentives to stabilize desired interactions and destabilize undesired interactions.

Finally, we should remark that whistle-blowing systems to overcome cartels of silence are not without their fair deal of criticism. In some countries and cultural contexts, whistle-blowing as a system operated within organizations triggers uneasy moral feelings. In Germany, for example, observers have criticized whistle-blowing policies as “spying,” “denunciation,” “Stasi methods”—sometimes even as “Nazi methods” which is one of the worst criticism a practice could earn in modern-day German culture. Such semantics reveal a profound fear that whistle-blowing systems could be abused to attack civil rights, undermine freedom or institutionalize a system of general suspicion among employees.

From the perspective of business ethics, however, such criticism reveals two essential aspects to be taken seriously when whistle-blowing systems are to be established within organisations.

- First, the criticism shows that certain phenomena such as trust or loyalty are not per se good or bad but ambivalent. Their functionality depends on the context within which they occur, and their results materialise. In the small group contexts of teams, for example, many if not most people will feel uneasy about criticizing their colleagues for an alleged offence, much less reporting them to top management. In these contexts, moral psychology tells us that an age-old evolutionary moral program drives people to react intuitively with loyalty and do what is necessary to make group cooperation succeed (Haidt 2012, Greene 2014). This loyalty to team members, however, conflicts with the loyalty of employees towards their organization, which suffers losses if corruption remains undetected.
- Second, whistle-blowing systems, therefore, need to be implemented with care, and their careful implementation needs to reflect the ambivalence of loyalty and trust. Ethics training, for example, need to raise awareness of these two loyalties, and the potential conflict among them. On the one hand, loyalty (to team members) can be wrong-headed and lead to bad outcomes if confidants fail to report colleagues for a clear-cut violation of anti-corruption policies. On the other, criticising colleagues and reporting them can be an act of loyalty (to the organisation) with good outcomes for all members of the company. So, one crucial task of ethics

trainings is to criticise the gut feelings that lead people to support group members even when faced with severe wrongdoings. Similarly, codes of conduct should exemplify best practices cases informed by the ambivalence of loyalty and trust. And, finally, ombudspersons should be sensitive to the possibility that whistle-blowing systems can also be used and misused to denounce unpleasant but otherwise impeccable colleagues—and pre-empt against it. The crucial insight is that organizational integrity requires management to support employees and other stakeholders in their efforts to make sense of the quality and appropriateness of their moral intuitions and the moral status of functional incentive arrangements to fight corruption (Will and Pies 2018).

4. Conclusion

Corruption is not only a serious problem. It is also a complex one. Preventing corruption thus requires constructive learning processes. Against this background, this paper has outlined a guideline how this can be done by and within companies. We summarize our finding with three different propositions.

First, from the point of view of companies, corruption is a social dilemma. In a race of corruption, companies damage each other, and this collective self-damage constitutes a common interest to engage in an effective fight against corruption. Activating this interest opens up a promising avenue to realize an important moral concern in society.

Second, addressing corruption requires functional (self-)commitments. To overcome the race of corruption between companies, collective (self-)commitments of *all* companies are necessary. Internally, however, each company can also bind itself to overcome undesirable and establish desired social dilemmas with an appropriate incentive arrangements, for example a whistle-blowing system.

Third, dysfunctional semantics—i.e. thought categories, world views or ideas—can hinder functional rule reforms, in particular, in preventing corruption. On the one hand, in the context of new governance processes, companies should not primarily be seen as a problem, but as partners in finding a solution. On the other, it is important to understand the ambivalence of supposedly unambiguously positive phenomena. For example, trust is not always good. A functional integrity management can therefore also consist of deliberately destabilizing dysfunctional trust relationships.¹²

¹² Cf. Pies and Beckmann (2009).

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Autoren:

Prof. Dr. Ingo Pies

Lehrstuhl für Wirtschaftsethik

Martin-Luther-Universität Halle-Wittenberg

Dr. Stefan Hielscher

University of Bath, UK

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