Play fair! Innovating internal self-regulation in the market for profit

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Abstract Regulation imposes compliance demands on business, but these controls by no means ensure that corporations will act ethically. Externally imposed controls by government or industry are prompts intended to move organizations to engage in a moral minimum. Such efforts are typically reactionary corrective measures, often crafted and applied after an ethical scandal occurs, and thereby offer limited effectiveness in providing systemic change. To provide insight on internally driven controls, this article examines how a newer form of monetized self-regulation, referred to as inverted moral markets, might be leveraged to motivate corporate ethical behavior. Inverted moral market (IMM) operations target firms suspected of unethical action, providing a type of market whistleblowing. Such activities are monetized through the sale of information to investors and by short selling. Rather than a desire to build moral strength, IMM firms are motivated by self-interest and profit. They can potentially ‘do good’ by imposing self-correction within the market, but without virtuous intent. We explore IMMs and the varied impacts their activities may have on the functioning of the overall market. We argue that a more balanced approach between internal and external regulation may enhance the environment for moral balance in a capitalist market system.

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1. Limitations of external regulation

There is one and only one social responsibility of business—to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engages in open and free competition, without deception or fraud.
— Milton Friedman (1962, p. 112)
With over 40 years of scholarship advocating corporate social responsibility (Post, 2015), many have come to embrace the notion that firms need to do more than what is required by law to be ethical. Friedman’s treatise on capitalism assumes firms engage in fair play, requiring some level of ethicality where goals are achieved without deceit (e.g., cheating, bribery, corruption, fraud). Those in business, however, do not always adopt this assumption, and thus we see more and more government imposition of regulatory controls (Wagner-Tsukamoto, 2007). Firms tend to adopt a compliance-based approach aimed to prevent unethical activity rather than to promote ethical strength (Sekerka, 2012). As a result, we see an ongoing cycle of adding more and more compliance-based requirements that continue to impose costs on firms and their stakeholders with no promise of ethics development or change.

This cycle has contributed to corporate regulators adopting a variety of platforms that led to the commodification of regulation worldwide (Djelic, 2006). The notion of regulation as a product of exchange transforms the idea of regulatory control—traditionally viewed as an externally imposed demand—to one that includes internally derived opportunities for monetized trade. A commodity is, at its fundamental level, a transactional exchange—an action offering economic value. Thus, regulation as a commodity implies there is mutual benefit for those engaged. Given a firm’s desire to maintain autonomy and the government’s inability to be effective and/or to assume full responsibility for business ethics, we wondered how capitalistic motives might be leveraged to help infuse and/or restore ethical balance to market regulation activities. Drawing on literature from economics and business ethics, we provide a description of what we refer to as an inverted moral market (IMM). In describing IMMs, our article illustrates how capitalistic forces can be used to develop a market for services that impose a self-interest-driven corrective energy to prompt fair play. Because the aim is not to achieve a moral act but to make money, there is an inverted or inverse motive as those adopting this practice move toward a potential moral outcome (purging the market of unethical actors). Underlying this idea is the question of how self-regulation may unfold without ethical intent. We argue that IMMs represent a form of incremental rather than radical change.

2. Inverted moral markets

Businesses that find and target wrongdoers for profit are the drivers of IMMs. They regulate by short selling shares and selling the information itself before making the information public. An expectation is that, once public, this information will set off a wave of share selling, which then drives down the share price of the wrongdoer and makes the IMMs’ short position profitable. While not by design, IMMs inadvertently instill a self-correcting mechanism, offering a means of market retribution for foul play that simultaneously restores moral balance to the game. To better understand this innovative business concept, we look to answer this central question: When IMMs profit from revealing the unethical activity of a targeted firm, does this add value to the market and society as a whole?

Adam Smith (1776) explained how the pursuit of self-interest promotes the common good. Since his treatise, there has been a longstanding debate as to whether or not self-interest actually fosters societal welfare or stands in stark contrast to it (Cosans, 2009). The relentless trail of media stories about unethical corporate actors working at firms like Turing Pharmaceuticals, Toshiba, Valeant, Volkswagen, and Wells Fargo Bank demonstrate how regulatory controls often fail to ensure fair play in the market. While accounts of wrongdoing often evoke a sense of indignation among stakeholders, corporate cultures of ignorance, moral myopia, and complacency seem to persist. With each scandal, the public increasingly realizes that the presence of unethical behavior in business has become the norm rather than an anomaly (Palmer, 2013). Reliance upon organizational members to be the internal policing agents within an organization is a woefully inadequate means to deter, identify, and address fraudulent and unethical behavior (Blount & Markel, 2012). A new approach to see how firms can foster ethical strength is certainly needed (Hess & Broughton, 2014). We see the current insufficiency to ensure fair play in the market as a possible opportunity for incentivized market self-regulation. Put differently, innovative regulatory design is needed to instill moral balance in the marketplace.

2.1. Telling for profit

Anonymous Analytics, Citron Research, Gotham City, Iceberg Research, Muddy Waters, and The Friendly Bear exemplify IMM-type firms. Their operations are often described as mission-based to foster transparency. However, the concern for transparency is hardly motivated by ethical concerns, but rather by a desire to create wealth. These companies are self-interest-driven operations imposing a non-virtuous form of market whistleblowing. Said differently, IMMs are the market
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