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An Adversarial Ethic for Business: or When Sun-Tzu Met the Stakeholder

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ABSTRACT. In the economic literature on the firm, especially in the transaction–cost tradition, a sharp distinction is drawn between so-called "market transactions" and "administered transactions." This distinction is of enormous importance for business ethics, since market transactions are governed by the competitive logic of the market, whereas administered transactions are subject to the cooperative norms that govern collective action in a bureaucracy. The widespread failure to distinguish between these two types of transactions, and thus to distinguish between adversarial and non-adversarial relations, has led many business ethicists to develop a "uniform" moral code. Yet in market transactions, the checks and balances built into the system of commercial exchange are such as to permit more instrumental forms of behavior. In administered transactions, by contrast, these checks and balances are absent, and thus the institutional context calls for much greater exercise of moral restraint. In this paper, I begin the task of developing an adversarial ethic for business. According to this view, the competitive environment licenses a greater range of "self-interested" behavior, but also imposes its own constraints on the strategies that firms may adopt in the pursuit of their interests.

KEY WORDS: adversarial ethics, competition, market failure, corporate social responsibility, philosophy of sport

Some of the most serious confusions to arise in the business ethics literature stem from a failure to distinguish adequately between the moral obligations that managers have toward individuals who are "outside" and those who are "inside" the corporation. In the economic literature on the firm, especially in the transaction–cost tradition, a sharp distinction is drawn between so-called "market transactions" (which involve buying and selling in the market) and "administered transactions" (which are governed by the rules that structure the bureaucratic hierarchy of the firm) (Shipman, 1999, 267; Williamson, 1975). The reason this distinction is so important for business ethics is that market transactions are governed by the *competitive* logic of the market environment in which the firm operates, whereas administered transactions are subject to the *cooperative* norms that govern collective action in a bureaucracy.

Generally speaking, the norms that structure systems of cooperation are significantly more exigent, from the moral point of view, than those that govern competitive behavior. Indeed, one of the hallmarks of competition – and one of the reasons that many people feel such unease with it – is that it appears to offer individuals temporary and partial exemption from some of the norms that ordinarily structure interpersonal relations. Thus, competition permits forms of behavior that would, in other contexts, typically be regarded as anti-social. There are many examples from the field of competitive sport that could be drawn upon to illustrate this principle. There is a special branch of ethics, referred to as *adversarial ethics*, that deals with the problem of determining appropriate standards of conduct in such contexts.[1] So far, however, there has been little or no recognition of the fact that a significant portion of the issues traditionally dealt with by business ethicists, viz. those that pertain to market transactions, fall into the domain of adversarial ethics.

The widespread failure to distinguish between market transactions and administered transactions, and thus to distinguish between adversarial and non-

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adversarial relations, has led many business ethicists to develop a "uniform" moral code, suggesting that the same test, or that the same standards be applied in all circumstances, and in every transaction. This leads to a problem that has become endemic in the business ethics literature. In order to set a uniform standard "high enough" to govern cooperative relations within the firm (and thus to handle issues like employee health and safety, personnel management, and so on), it must be set so high that it essentially precludes adversarial behavior. This makes marketplace competition impossible, from the moral point of view, and so makes business ethics implicitly anti-capitalist (Goodpaster, 1991, 66; *The Economist*, 2005). Yet if one turns around and lowers the standard, in order to permit adversarial behavior toward competitors, the moral code winds up licensing all sorts of sharp practices within the firm that are not only unethical, but that are even incompatible with the imperatives of good management (dependent, as the firm is, upon norms of reciprocity and a climate of trust in order to secure the good will and loyalty of its employees). This does an enormous amount to heighten the perception that, while ethics in business are all well and good, they represent niceties that, when push comes to shove, may need to be set aside.

The solution to this problem lies in the recognition that moral obligations in business are not uniform. There is, rather, an institutional division of moral labor. In market transactions, the checks and balances built into the system of commercial exchange are such as to permit more instrumental (or "self-interested") forms of behavior. In administered transactions, by contrast, these checks and balances are absent (indeed, managers often wield great power over the lives of subordinates), and thus the institutional context calls for much greater exercise of moral restraint. This is a very old idea – that the "invisible hand" of the market transforms certain vices into virtues, in a way that the "visible hand" of management does not. Unfortunately, those who take this line of reasoning seriously have had a tendency to overstate their case (e.g., by claiming that markets obviate the need for any sort of moral restraint [Gauthier, 1982]). This has created, in turn, a rather hypertrophied aversion among business ethicists to any discussion of the ways in which markets might license *a selective* exemption from everyday moral norms.

In this paper, I would like to begin the task of developing an adversarial ethics for business. I do so by, first, analyzing the structure of competitive behavior, along with the specific forms of competition that constitute the economic environment in which firms operate. I then go on to show how this competitive environment licenses certain forms of "self-interested" behavior, but also imposes its own limits on the strategies that firms may adopt in the pursuit of their interests. This constitutes the core of an adversarial ethic for market transactions, one that is clearly distinct from the norms that govern administered transactions.

The nature of competition

Morality arises in response to the fact that human affairs, when left to their own devices, have a tendency to go very badly. Thomas Hobbes summed it up best with his observation that the unbridled pursuit of individual self-interest generates a "natural condition" in which life is "solitary, poor, nasty, brutish and short." This is because individuals who refuse to exercise any restraint in the pursuit of their self-interest rapidly become embroiled in collective action problems – interactions in which, despite acting in a self-interested fashion, each individual winds up with an outcome that is much worse than some other feasible outcome, which might have been achieved had they all chosen to act differently. Furthermore, a collective action problem can easily degenerate into a race to the bottom, in which each individual, responding to the actions of the others, generates an outcome that is successively worse, but where each iteration of the interaction only intensifies their incentive to act in the same way. An arms race is the most clear-cut example.

One of the primary functions of morality (and of social institutions more generally) has always been to impose constraints that prevent individuals from falling into these sorts of collectively self-defeating patterns of behavior (see Gauthier, 1986; Schotter, 1981). A simple golden rule, for example, which asks individuals to consider, before embarking upon a particular course of action, how they would feel if *others* acted the same way, has the potential to resolve the overwhelming majority of collective action problems, and thus to promote mutually beneficial forms of

cooperation. Consider, for example, the rule against littering. When leaving a subway car, it is tempting to leave one's newspaper behind, rather than carry it along in search of a trash can. At the same time, people generally do not like riding in messy subway cars – the only reason they are tempted to leave the newspaper behind is that they are exiting the train. This creates a collective action problem (or a prisoner's dilemma). Figure 1 shows a simplified version of this game involving two riders, along with a graph of the payoffs (representing the level of satisfaction that the riders get from their morning commute).

The norm that prohibits littering takes the riders of the subway away from the strategic equilibrium, which is (1,1), and allows them to achieve the cooperative outcome (2,2). Of course it is still in the *interest* of each rider to defect from the cooperative arrangement by littering. The social norm, insofar as it does constrain the conduct of the two riders, represents a genuine constraint; it is not merely their self-interest correctly understood. What makes the norm advantageous is the fact that general compliance generates a win–win outcome. This is the hallmark of moral action. (The philosopher Kurt Baier has written, with considerable plausibility, that being moral simply means "following rules designed to overrule self-interest whenever it is in the interest of everyone alike that everyone should set aside his interest" [1958, 314]. Even if this is not *all* of morality, it is certainly a sizeable chunk of it.) Immoral action, on the other hand, tends to generate win–lose outcomes (and when everyone does it, lose–lose outcomes).

This analysis makes it somewhat easier to see why *competition* often appears to be so puzzling, and for many people, so morally problematic. While cooperation is designed to deliver win–win outcomes, competitions are specifically designed to produce win–lose ones (Skillen, 1998, 171). Furthermore, the structure of a competition is designed to induce all of the competitors to defect rather than to cooperate (Heath, 2001, 93–97). Take the example of an athletic competition, such as long-distance running. If you took a randomly selected group of people and told them to run a race, promising to give a prize to the fastest, then generally speaking the prize would go to the person with the most natural ability (the right sort of frame and musculature, the best cardiovascular system, etc.). On the other hand, if you announce the contest well in advance, it is possible for those with less natural ability to improve their chances of winning by *training* for the race (thereby improving their musculature, cardiovascular system, etc.). Yet when the less talented begin to train, this just forces those with more natural ability to train as well, so that they can retain position. At the end of the day, when everyone trains equally, the person with the most natural ability still wins. Yet, everyone involved in the competition now is expending much greater time and effort to achieve this result, and thus the outcome is suboptimal from the standpoint of the competitors. In other words, training for an athletic competition is a form of defection (equivalent to littering the subway car, in Figure 1). In fact, it is one that generates a race to the bottom. If everyone is training three hours a day, it gives those with less natural ability an incentive to train four hours a day. When those with more talent start to match that, and train four hours a day, it simply gives those with less talent an incentive to train five hours a day, and so on.

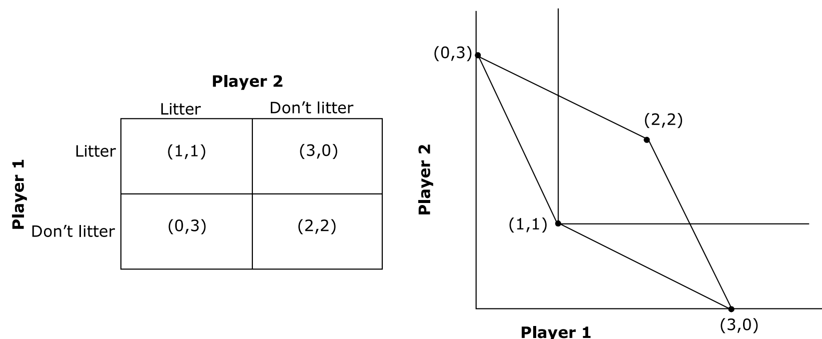

Figure 1. Prisoner's dilemma.

The fact that training has this sort of structure has not escaped the attention of athletes. As Robert Frank and Philip Cook observe:

> The Academy Award-winning film *Chariots of Fire* portrays British collegiate track-and-field competitors who have developed an implicit norm that limits their training and practice time. Their apparent understanding is that since the most talented runner will win whether all train arduously or none does, the sensible thing is for no one to train very hard. This arrangement is challenged by an outsider with a rigorous training regimen. In response the incumbents bring considerable social pressure to bear upon the maverick. In the face of such pressure, most normal challengers might have succumbed. But this particular runner is tough, and he goes on to win in the end (Frank and Cook, 1995, 142).

Of course, when it comes to competitions our sympathies lie with those who ''break ranks'' and adopt the non-cooperative strategy of training. Indeed, the *point* of a competition is to encourage precisely this sort of ''one-upmanship.'' Yet, why would society want to inflict this peculiar sort of collective action problem upon people? The answer is that desirable competitions also generate positive externalities – benefits to people other than those directly involved. The competition is precisely how society induces those involved to produce these benefits, despite the personal inconvenience that it entails. Olympic athletes, for instance, might prefer not to have to give up their entire lives to train, but the intensity of competition generates a riveting display, in which spectators can see the frontier of human achievement being pushed back year after year.

Thus, the reason that ''society'' favors competition in certain areas of life has everything to do with the externalities that are generated. The difference between *healthy* and *unhealthy* forms of competition is that, in the former case, the external benefits outweigh the losses incurred by the competitors, while in the latter case they do not. Compare the case of training to that of performance-enhancing drugs (see Simon, 1988). Both have the structure of a defection strategy. When one person starts training, everyone else is forced to train as well, in order to have any chance of winning. In the same way, when one person starts taking steroids, everyone else has to take steroids as well, in order to have any chance of winning. The difference is that training, although it represents an inconvenience to many people, usually improves the athlete's overall health, whereas performance-enhancing drugs have serious adverse health effects in the long run. (Indeed, it is a testament to the intensity of the race to the bottom among athletes that so many are willing to take them, and so many more would be willing to do so, in the absence of regulations prohibiting it and testing to monitor compliance.)

This is why competitions need to be so carefully monitored and regulated. In general, the participants are motivated by the incentive to defect, i.e. the desire to win, and not by the overall ''social'' objectives of the competition.[2] If this were not the case, then there would be no need to test for performance-enhancing drugs; athletes would simply refrain from taking them on the grounds that they are not ''good for the sport.'' Yet, the logic of the collective action problem at the heart of athletic competition generally precludes this sort of high-mindedness. Thus, healthy competitions are always in danger of degenerating into unhealthy ones. There was no better reminder of this than the scandal that erupted in American figure-skating in 1994, when skater Tonya Harding sent a member of her entourage out to kneecap her primary rival, Nancy Kerrigan. Needless to say, the point of a figure-skating competition is not to see who will be left standing at the end of the day, but rather to see who can perform the most impressive on-ice maneuvers. Practicing is a legitimate way of besting one's rivals; sending out thugs to handicap them is not. The former generates positive externalities that make the competition a ''race to the top,'' while the latter clearly transforms it into a ''race to the bottom.'' Thus, the difference between healthy and unhealthy competition lies not in the intentions of the competitors, but rather in the rules that constrain them, and keep them from employing strategies other than those that generate positive externalities. There is nothing intrinsically right or wrong about any particular competitive strategy (after all, they are all forms of non-cooperative behavior), the question is simply whether the strategies chosen promote healthy or unhealthy forms of competition.

One can see already how this peculiar structure makes the moral evaluation of competitive behavior rather tricky. The problem is that the beneficial consequences of a competition arise necessarily as a *by-product* of the competitive activity, while the objectives that the participants themselves seek often seem morally objectionable *prima facie*. The virtues of the competition, such as they are, are associated with the institutional structure (i.e. the set of rules) that constrains the participants' behavior, and not necessarily the intentions of the participants. Indeed, insofar as a competition does produce beneficial consequences, it is almost as though the participants were guided, by an invisible hand, to promote an end which was no part of their intention.

Competition in business

Everyone knows that businesses operate in a competitive environment. However, the way that market exchange is presented in the standard microeconomics curriculum sometimes obscures the fact that marketplace competition also has at its core an unresolved collective action problem (indeed, it is not just an unresolved collective action problem, but an *institutionalized* collective action problem, since attempts to resolve it are widely prohibited by anti-trust law). Thus, it is worth reviewing briefly the structure of marketplace competition.

Familiarity with so-called ''general equilibrium'' models has conditioned many people to think of the point at which supply and demand curves intersect as *the* equilibrium of an exchange, and the price level at that point as *the* equilibrium price. Under certain conditions this may be true of aggregate supply and demand, but it is not true of individual supply and demand curves. When there is only one buyer and one seller, *every* price level at which some positive quantity of goods would be exchanged is the Nash equilibrium of a marketplace interaction in which either the buyer or the seller makes a ''take-it-or-leave-it'' offer to the other. Consider Figure 2. The seller may find it advantageous to sell quantity x_1 at price level p_1, rather than x_2 at p_2. If he makes a ''take-it-or-leave-it'' offer to the buyer at that price, and the buyer believes that the price is firm, then it is in the buyer's interest to accept.

This is why buying and selling in one-on-one interactions often involves so much posturing. Both parties know that if the other believes that the ''final offer'' is indeed a final offer, then he or she will accept, so long as the price is within the zone of exchanges that generate a mutual benefit (i.e. a ''gain from trade''). However, there is no guarantee that the exchange will *maximize* the mutual benefit. Thus, the seller may wind up with unsold goods at the end of the day, simply because it was best to sell a smaller quantity at a higher price. In other words, there is no expectation that *markets will clear* in exchanges between only one buyer and one seller.

As soon as another buyer or seller enters the market, however, the strategic situation changes completely. The presence of multiple buyers and sellers dramatically reduces the ability of any one buyer or seller to make a credible ''take-it-or-leave-it'' offer. If the price that the sellers are charging is above the price at the point where supply and demand curves intersect, then they will wind up with unsold goods at the end of the day. If they are both charging the same price, then one can assume that they will split the sales between them, and so both wind up with unsold goods. Yet this creates a temptation for both sellers. By dropping the asking price somewhat, it should be possible to sell one's entire inventory. The loss of revenue caused by the lower price will then be made up for by the

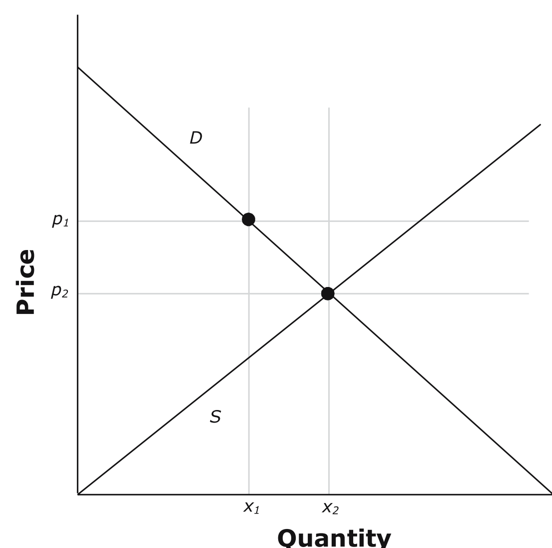

Figure 2. Market exchange.

increased volume of sales. Of course, if one seller does this, then the other has no choice but to respond in kind. The result is lower profits for both of them. This competition will continue until the volume of sales at a given price level leaves neither of them with unsold goods. This is the point at which supply and demand curves intersect (which is why the price at that point is known as the "market-clearing" price). The same sort of competition develops among buyers in cases where the price is lower than the market-clearing price – some buyers will be left with unsatisfied demand at the end of the day, and so will have an incentive to defect, by paying more than the going rate, in order to guarantee that they secure enough of the good.[3]

Clearly, it is not in the joint interest of either suppliers or buyers to compete with one another in this way. Thus, the reason that price competition is desirable is not that it benefits the people involved, but rather that it generates external benefits for society at large. In this respect, it is quite similar to athletic competition. But what are these external benefits, in the case of the competitive market? When suppliers compete with one another it benefits buyers, and vice versa. Thus the competitive market works to eliminate "deadweight losses" from the economy, ensuring that the maximum number of mutually beneficial economic exchanges take place. But more importantly, a competitive market also gives rise to a set of *prices*, which provide crucial information to everyone else in society about the relative scarcity of the various resources, skills, goods and services being exchanged. In the same way that an infrared camera takes invisible light and converts it to a wavelength that the human eye can see, the competitive market takes people's invisible preferences regarding both production and consumption and converts them to something that can be observed with the naked eye, viz. prices. This is what makes economically rational decision-making even roughly possible in every sector of the economy, including the public sector. The operation of the price system therefore allows for a more efficient (i.e. less wasteful) use of resources and labor.

Furthermore, the failure on the part of either producers or buyers to compete with one another can cause considerable mischief, insofar as it sends the wrong "signals," via the price mechanism, to other economic actors. When suppliers, through collusion or cartelization, are able to maintain prices for some good at above-market-clearing rates, it suggest that there is "not enough" of that good, and so encourages a shift of resources away from other economic activities towards increased production of that good, combined with a shift among consumers toward goods that serve as substitutes (assuming such are available). Similarly, when buyers form a "consumer co-op," or some similar organization, in order to hold out for lower prices, it sends the signal to suppliers that there is "too much" of the relevant good, and so encourages them to shift investment out of that sector.

This is, of course, the substance of "invisible hand" arguments for the market since Adam Smith. It is why David Gauthier, in his article "No Need for Morality: The Case of the Competitive Market," argues that in market transactions, moral constraints "would be not merely pointless, but positively harmful" (Gauthier, 1982, 54). One is not merely encouraged to act non-cooperatively in a competitive market, social welfare considerations *require* one to do so, because the price mechanism requires competition in order to generate the right information about the relative scarcity or need for different goods.

Of course, it is important to recognize that there is nothing magical about the ability of markets to transform private vices into public virtues. This sort of laundering is a general feature of all competitively structured social interactions. And like all other forms of competition, market competition must be governed by a set of rules, restricting the range of strategies that individuals may employ, in order to ensure that it remains healthy. For suppliers, offering to sell at a lower price – and making the necessary changes in the production process that will enable one to do so – is the most important permissible strategy. Adjusting the quantity that is supplied, and making improvements in product quality are also permissible.

But like every other form of competition, market competition also has a tendency to go off the rails when improperly regulated. In principle, there is no reason why firms could not compete with one another by blowing up each others' factories and hiring assassins to kill each others' CEOs. Such a scenario is no less implausible than figure skaters sending out thugs to kneecap their opponents. In fact, one need only look at the experiences of the

various "transition economies" in the former Communist bloc to see the sort of outrageous behavior that improperly regulated marketplace competition may generate. For example, in 1994, shortly after the privatization of agriculture and food production in Hungary, the country was swept by an epidemic of lead poisoning. After searching far and wide for the cause, doctors and scientists finally tracked down the source of the problem. Manufacturers of paprika – a staple of Hungarian cuisine – had been grinding up old paint, much of it lead-based, and adding it to the spice in order to improve its color. The practice was so widespread that officials in Hungary were forced to order all the paprika in the country removed from store shelves and destroyed. This is a clear example of firms using an impermissible strategy – exploiting an information asymmetry – in order to compete, and other firms being forced to do the same, in order to retain position. The race to the top of the competitive market is thereby transformed into a race to the bottom, one that can have devastating consequences for the society at large.

The morality of competition

Much of everyday morality has as its goal the prevention of collective action problems. It is possible to secure certain advantages by lying, but if everyone did it, no one would believe what anyone said, and everyone would be worse off. It is possible to advance one's interests by stealing from others, but if everyone did it, everyone would have to make costly investments in security and protection, etc. This is why the various formulations of the Golden Rule capture much of the spirit of everyday morality. But because the central mechanism in a competition is an unresolved collective action problem, there are bound to be numerous *prima facie* conflicts between competitive imperatives and those imposed by everyday morality. This is reflected in the fact that a naïve or mechanical application of the Golden Rule in a competitive situation is likely to generate the wrong results. Before kicking in the winning field goal, we do not want football players to be thinking, "How would I like it if the other team did that to me?" Similarly, before lowering prices, we do not want gas-station owners to be thinking "How would I like it if the station across the street did that to me?"

There is some debate among ethicists as to whether this conflict with everyday morality is real or apparent. Arthur Applbaum has offered a critical survey of arguments that "have been offered to back up the claim that the rules of [competitive] games provide moral permission to use tactics that would otherwise be wrong" (1999, 115). He argues that this conclusion, which seeks to dissolve the tension between adversarial practices and everyday morality, is in fact much more difficult to sustain than many have imagined. In some cases, participants sign waivers, whereby they explicitly consent to be treated by others in the way that the game rules dictate. But more often, whatever consent is present is merely implicit, and generalizing from this sort of consent to the moral permissibility of prevailing practices is fraught with difficulty. For example, Applbaum observes that, "when alternatives to participation in a game are poor, expectation of an adversary game does not imply consent to its rules. In buying a used car, you may fully expect to be deceived about its defects" (1999, 117) – this does not mean that the dealer is morally entitled to deceive you.

Thus, Applbaum argues that, in the majority of cases, adversarial institutions generate behavior that is morally wrong *pro tanto*, but perhaps permissible *all things considered*, i.e. when the systemic consequences of that behavior within that institution are brought into the picture. In the case of competitive behavior, this means that the consequences of defecting from the cooperative arrangement constitutes a genuine harm for the other competitors, but that the wrongness of this harm is outweighed by the positive externalities generated by the competition as a whole (e.g. the "ratcheting up" of effort and skill in a sporting competition), and thus the action in its context is morally permissible. This is, of course, still a somewhat tricky position to defend, since it involves a certain instrumentalization of the other competitors. The general point, however, is sound. Adversarial institutions do not provide individuals with a moral "get out of jail free" card, such that categories of moral evaluation no longer apply to their conduct (leaving them free to pursue whatever course of antisocial behavior happens to suit their fancy). In other words, these institutions do not dissolve morality.

What they provide is, at best, a set of highly specific exemptions from particular moral obligations.

One can see this clearly reflected in the morality of sport. In fact, we can learn a great deal about the morality of adversarial relations by examining sports, both because games are highly artificial constructs, and so are governed by an unusually explicit set of rules and regulations, but also because sports play an important educational role in the socialization of the young, and so the underlying moral ideals tend to be quite well articulated. One need only look at what parents and coaches say to children after a game has gone poorly. The central moral ideal here is known as "sportsmanship" (Feezell, 1988) or "being a good sport." This is a complex ideal, one that involves a number of different characteristics.[4]

Constrained competitiveness

The good sport is one who maintains a zealously adversarial stance within the designated context of the game, but then drops this orientation and adopts a more cooperative demeanor when the game is over. Thus a classic way to demonstrate good sportsmanship in a contact sport is for a player, after having knocked an opponent down, to offer him a hand up after the whistle is blown. The whistle that stops the play effectively signals a switch from adversarial to cooperative relations; a good sport is one who is able to make this switch without allowing residual ill will from the competitive segment to poison relations in the cooperative. (Indeed, one of the reasons that competitive sports are often thought to "build character" is that they force children to develop this more advanced form of self-control.) For similar reasons, a good sport does not "rub it in" after having won or behave sullenly after losing, but is rather "courteous in victory, gracious in defeat." Again this is a way of emphasizing the point that the win–lose structure of the interaction is confined to specific actions taken in the game; it does not extend to general participation in the sport.

No cheating

This almost goes without saying, but a good sport is one who respects the rules of the competition, even when the referee is not looking, or the chances of detection are slight. That having been said, it should be noted that the temptation to cheat is perhaps greater in adversarial relations than in everyday cooperative ones, precisely because the competition is already structured as a race to the bottom among competitors. Thus, the temptation to cheat may require greater force of character to resist in sport (another reason that it is felt to build character in the young). As we have already seen in the case of anabolic steroids and other banned performance-enhancing drugs, cheating can be a serious problem in sport, and has the potential to undermine all of the beneficial side effects that make the competition "healthy" in the first place.

No gaming

"Gaming" the rules involves taking actions that are technically not prohibited, but are not *intended* to be permissible strategies. Such actions violate the spirit, rather than the letter, of the rules, and are prohibited by the ideal of sportsmanship.[5] Such strategies are sometimes referred to as "exploits" (precisely because they exploit an unintended feature of the structure of the competition). They involve actions that *would be* against the rules, but for some oversight (e.g. it never occurred to anyone that players would do it) or impracticality (e.g. it is impossible to enforce a rule against it). An example would be the use of bronchiodialators among athletes to enhance their cardiovascular efficiency prior to a competition. The problem is that there is no real way to distinguish between those who genuinely have asthma, and so need the medication, and those who use it in the hopes of enhancing their performance. Thus, these substances are not officially banned, even though their use in many cases is clearly contrary to the spirit of the regulations that prohibit performance-enhancing drugs.

Taking the high road

Finally, and most fundamentally, the good sport is one who considers respect for the principles of good sportsmanship to be more important than winning. Faced with an opponent who has decided to "play

dirty,'' the good sport does not take this as license to start playing dirty herself.[6] The consequence is that she may often suffer defeat, rather than stoop to the level of an unscrupulous opponent. This requires the greatest self-control of all, since it requires not just overcoming the desire to win, but also suppression of our disposition to punish, through reciprocation, those who violate moral norms.

The function of the rules that govern a sport is to promote healthy competition. The morality of sport is clearly structured by the same interest. In many cases, it simply complements the official rules, by mandating respect for the spirit, as well as the letter, of the rule. A competition is socially beneficial when players exercise restraint in the strategies that they employ, when they confine their adversarial behavior to certain specific contexts, and when they refrain from allowing moral lapses on the part of other competitors to transform the entire contest into a race to the bottom. Moral judgment, in this case, is always guided by a sense of what the overall ''point'' of the competition is, what the beneficial consequences of the activity are, and how the competition serves to generate them.

Implications for business ethics

There can be little doubt that the core element of any plausible conception of business ethics is going to be a system of principles that mandates cooperative behavior with regard to the various agency relationships that exist within the firm, first and foremost, the principal–agent relationship between senior management and shareholders (Buchanan, 1996). These moral obligations are deeply entrenched, both in terms of institutional practices and in corporate law – most obviously, in the fact that courts treat senior managers as fiduciaries of the firm, and directors as fiduciaries of shareholders (Clark, 1985). The problem with this conception, however, is that it generates a system of moral obligations that tracks the agency relationships, and thus directly mirrors the organizational hierarchy of the firm. Individuals have duties toward those who are, in some sense, their superiors; employees toward their supervisors, managers toward executives, executives toward the board of directors, and via the board of directors, the shareholders. But what about other individuals who may be affected by the actions of the firm? What about customers, creditors, suppliers, or local communities? A conception of business ethics that focuses too narrowly upon obligations toward shareholders appears to give individuals free reign to engage in ''sharp practices'' in dealings with the latter groups.

Faced with this difficulty, one of the most influential impulses among business ethicists has been to take the fiduciary relationship that exists between managers and shareholders and use it as a model for positing additional fiduciary responsibilities between managers and so-called ''stakeholder'' groups. The claim, in effect, is that managers are agents with multiple principals, who must therefore exercise a duty of care and loyalty toward all of these different stakeholder groups.[7] Of course, many others have felt that this is the wrong way to proceed. Unfortunately, those who are opposed to this sort of ''multi-fiduciary'' stakeholder analysis have not done a very good job of formulating their objections. Several have suggested that managers should retain a fiduciary orientation toward owners, but their relations with other ''patron'' groups should be subject to deontic constraints (Goodpaster, 1991; Langtry, 1994). The standard argument has been that the relationship between managers and shareholders should be privileged because the latter are residual claimants, and are therefore much more dependent upon the good faith of management (Boatright, 2002, 47–48). The interests of all the other major stakeholder groups – with some notable exceptions – are protected by contract. Since the agency risks in such relationships are low, the imposition of fiduciary duties would be otiose (Easterbrooke and Fischel, 1991, 90–92).

The problem with this response, which defenders of stakeholder theory have emphasized, is that the *mere* fact that shareholders, as residual claimants, are more in need of protection from exploitation by managers than other stakeholder groups does not explain why there should be any sort of qualitative distinction in the nature of the moral obligations that are owed to them (Boatright, 2002, 50–51). It may explain why they are owed a *greater* duty of care, but it cannot explain why *only* they should be owed a duty of care.

A more persuasive response would build upon the distinction between administered transactions and market transactions. As Ronald Coase put it, the

most important organizational feature of the firm is the internal supercession of the price mechanism, along with the type of competitive behavior that it requires to function correctly. ''Outside the firm, price movements direct production, which is coordinated through a series of exchange transactions on the market. Within a firm, these market transactions are eliminated and in place of the complicated market structure with exchange transactions is substituted the entrepreneur-coordinator, who directs production'' (1937, 388). Thus, the difference in character of the moral obligations that managers owe to different individuals who are affected by the actions of the firm depends upon the nature of the transactions that occur between them, and in particular, whether these transactions are mediated through the price mechanism. Administered transactions – within the hierarchy of the firm, which includes both employees and shareholders (via the board of directors) – are organized as principal–agent relations, and are therefore governed by an essentially cooperative logic. This is why moral obligations in this case take on a fiduciary or quasi-fiduciary form, and are aimed at reducing agency risks. These obligations are, as Allen Buchanan has emphasized, obligations to *advance the legitimate interests* of the principal (1996, 424). Market transactions, on the other hand, are mediated by the price mechanism, and are therefore governed by an essentially competitive logic. Thus, moral obligations in this context have an adversarial character, because the market requires non-cooperative behavior in order to move prices toward the level that promotes the socially optimal use of resources. It follows quite naturally that these moral obligations cannot be fiduciary in nature, because one does not have an obligation to advance the interests of one's opponent in an adversarial context (if one did, then it would no longer be an adversarial context) It does *not* follow that these obligations may be any less strict, it just means that they must have a different form (see Figure 3).

It should go without saying that there are also significant competitive aspects to relations within the firm. Indeed, most firms use internal competitions of various sorts (e.g. for bonuses and promotion) as a way of motivating work effort. In the same way, there are significant cooperative elements in market transactions, especially in cases where long-term contracts are in place. But this sort of complexity does not change the fundamental structural distinction, which has to do with the dominant mode of social integration in these domains. Intense personal rivalries may develop among players on a sports team, just as players from different teams may develop tacit norms of cooperation that limit the scope of competition. Yet there is still a fundamental distinction between what you owe to players on your own team and what you owe to those on a rival team. The same is true in business.

Unfortunately, many theorists who are attentive to the difference between administered and market transactions have been misled by ''invisible hand'' arguments, which purport to show that *nothing* is owed to those on a rival team. Gauthier, for example, argues that because the perfectly competitive market reconciles the pursuit of self-interest with the production of socially beneficial outcomes, there is simply no call for moral evaluation: ''The traditional moralist is told that his/her services are not wanted'' (1982, 47). Thus, what he calls the ''visible foot'' of morality (''to be applied firmly to our backsides in order to redirect our concerns when individual gain an mutual benefit diverge'' [1982, 41]), may be required whenever the ''visible hand'' of management is present, but wherever the ''invisible hand'' does the work of integrating our actions there is no need for it. Thus, markets represent ''freedom from morality'' (1986, 83).

Gauthier does mention one important exception to this claim. In order to get the perfect coincidence of self-interest and mutual benefit, the market must be *perfectly* competitive, and in order

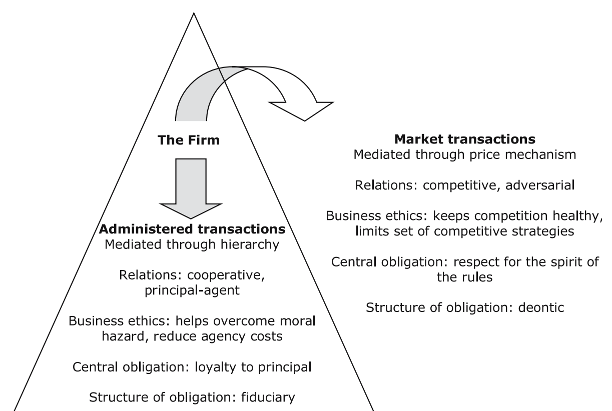

Figure 3. Administered and market transactions.

to be perfectly competitive, the market must satisfy certain conditions (usually referred to as the "Pareto conditions"). What Gauthier fails to emphasize is that it is impossible to satisfy these conditions in the real world. For example, perfect competition requires that there be no externalities and no information asymmetries *anywhere* in the economy. But there are always externalities and information asymmetries. Furthermore, it is not generally the case that the closest possible approximation of perfectly competitive conditions will yield the closest possible coincidence of self-interest and mutual benefit. Generally speaking, once one of the Pareto conditions has been violated anywhere in the economy, there can be no presumption that satisfaction of the other Pareto conditions will lead to a more efficient outcome.[8]

Thus, the invocation of the ideal of perfect competition as grounds for ignoring morality in the marketplace is, at best, the result of a weak grasp of the underlying economics, and at worst, positively misleading. This point has been emphasized by the economist Kenneth Arrow, who commands particular authority in this context, since it was he, in collaboration with Gerard Debreu, who finally proved the "invisible hand theorem," i.e. demonstrated that the equilibrium of a perfectly competitive market would be Pareto-optimal (Arrow and Debreu, 1954). Arrow's argument for "ethical codes" to constrain the conduct of business emphasizes that when the Pareto conditions are violated, "the classical efficiency arguments for profit maximization do not apply... and it is wrong to obfuscate the issue by invoking them" (Arrow, 1973, 308).

The problem with Gauthier's view (and those who share it, like Milton Friedman[9]), is that it confuses the adversarialism of market transactions with freedom from all moral constraint. Thinking that the invisible hand of the market eliminates the need for ethical conduct in business is like thinking that the competitive structure of sport eliminates the need for good sportsmanship. The market is not a free-for-all, any more than a competitive team sport is. Making a profit is the goal of business, in the same way that winning is the goal of competitive sport. But the point is not to achieve this goal by any means possible; it is to achieve it in a fair and honest way.

The reason that such obvious truths have so often been ignored is that the law already prohibits firms from employing excessively anti-social competitive strategies. Thus, some have been tempted by the view that it is redundant to constrain competition by adding on a moral prohibition, above and beyond the obligation to obey the law. But the law is a blunt instrument. If it is impossible to design a set of rules to create a perfect competition in sport, it is even more difficult to design a set of rules to perfect our system of markets. Thus, there may be cases in which is it possible to employ competitive strategies in business that, while not technically illegal, nevertheless defeat the purpose of the market system. It is here that moral constraint is required. Arrow, for instance, identifies the problem of externalities and of asymmetric information as two cases in which "the simple rule of maximizing profits is socially inefficient." In such situations, "it is clearly desirable to have some idea of social responsibility" (1973, 309).

Parenthetically, it is important to distinguish between this view and one that regards the relevant moral constraints as simply an application of everyday morality to the role of the manager. Goodpaster, for instance, argues (plausibly) that managers have a fiduciary obligation toward shareholders, yet non-fiduciary obligations towards other "stakeholder" groups. However, when pressed to identify the source of these non-fiduciary obligations, he denies that they arise from the managerial role itself, and suggests (implausibly) that they are simply a reflection of moral constraints that the principal is subject to. Thus, he argues that "the conscience of the corporation is a logical and moral extension of the consciences of its principals" (1991, 68). He criticizes the "invisible hand" view for suggesting that the agent has "'moral immunity' from the basic obligations that would apply to any human being toward other member of the community"(1991, 68).

The problem with this analysis is that the competitive structure of the marketplace, insofar as it demands certain types of non-cooperative behavior, does in fact offer agents limited "moral immunity" from the norms of everyday morality. Managers are expected to be tough negotiators, to act strategically in the interests of the firm, to fire unproductive employees, to refrain from nepotistic practices, etc.

Similarly, investors are entitled to withdraw their money from an unprofitable firm, regardless of the broader ''social consequences'' of their doing so. (This is essential to maintaining the ''hard budget constraint'' under which the private sector generally operates, with salutary consequences for the economy as a whole.) Thus, the moral constraints that the manager faces when dealing with various ''stakeholders'' are not merely the constraints of everyday morality, inherited from the firm's principals. There are a number of *sui generis* constraints that arise out of the managerial role, that are specific to the context of a competitive market economy. Indeed, their primary function is to specify the permissible means by which this competition can be pursued.

Take the example of advertising. Almost all advertising is false advertising by the standards of everyday morality. But from the standpoint of business ethics, this is neither here nor there. What *is* morally significant, with respect to the role-specific obligations of the manager, is that advertising has the potential to exacerbate information asymmetries in the market. Insofar as these information asymmetries undermine efficiency, such advertising runs contrary to the intended consequences of marketplace competition. In other words, it threatens to generate unhealthy forms of competition. The standard response on the part of the state has been to institute a set of ''truth in advertising'' laws, to prohibit advertising that makes *deceptive* claims, claims that are likely to mislead the consumer ''in material respect'' (Coleman, 1989, 16). Yet there are many cases in which claims can be made that are misleading, and yet not strictly speaking false (for example, food that is advertised as ''now fat free'' even though the product in question had never contained fat), or that are false without being materially misleading. These sorts of marketing claims are difficult, if not impossible, to exclude through regulation. But insofar as this sort of advertising works only by exploiting a market imperfection, in this case an information asymmetry, it is unethical. It remains legal only because it would be too costly or cumbersome to eliminate through regulation (or in some cases, simply because legislators have not yet gotten around to prohibiting it).

A similar situation arises when firms are given the opportunity to externalize costs (whether it be in the form of pollution, congestion, threats to safety, etc.). The presence of a pollution externality, for instance, means that the firm will be able to charge prices that are ''too low,'' relative to the true social cost of producing the good. Rather than actually reducing the cost structure of its operations, the firm is simply displacing these costs onto others through an extra-market mechanism. As a result, an excessive quantity of resources will tend to flow to employments that generate negative externalities, while too little will flow to the production of goods that generate positive externalities. Even worse, when one firm takes advantage of the opportunity to externalize some of its costs of production (e.g. by ''cutting corners''), it puts competitive pressure on all rival firms to follow suit. Thus, the exploitation of market failures can quickly transform the ''race to the top'' of the competitive market into a ''race to the bottom.''

The central ideal of an adversarial *ethic* for business should be the preservation of healthy competition, even when the law fails to offer sufficient guarantees. Looking at the specific ways in which markets can fail to promote healthy economic rivalry, and considering the analogy with the ethics of sport, we can suggest the following as a set of general conceptual templates for thinking about the conduct of business with respect to market transactions.

Do not exploit market failure

This is the form that the principle of *constrained competitiveness* takes in an economic context. As Applbaum has observed, many books on competitive strategy are essentially ''how-to'' guides for creating and profiting from market failures (1999, 194–195). Taking advantage of externalities, information asymmetries, and market power represent the primary forms of unethical conduct in this regard (for more detail, see Heath 2004, 84). The ''Pareto conditions'' that define the structure of a perfectly competitive market provide the chief guidelines for determining what counts as a market failure (see Schultz, 2001, 99–104), although it is important to note that these are only guidelines. Managers themselves, for instance, are usually best placed to determine whether a particular competitive strategy generates gains for the firm by a genuine lowering of costs, or rather by an uncompensated displacement of costs.

Do not cheat

In many cases, efforts on the part of the state to correct market failure generate bodies of regulation that are unenforceable (Coleman, 1989, 185–194). Other times, the penalties associated with violation of the law are so minor, relative to the gains that might be achieved, that the desire to maximize profits winds up favoring violation (Braithwaite, 1981). Nevertheless, managers are morally obliged to respect both the letter and the spirit of the law, regardless of the fact that, from a cost–benefit perspective, it is in their interest to cheat. Otherwise put, the regulatory environment in which businesses operate should be regarded as a system of moral constraints, and not merely as a set of incentives.

Do not game the rules

Any complex system of rules – such as a body of government regulation – will tend to have loopholes. There may have been oversights in the way that the rules were formulated, or the rules may simply interact with one another in unintended ways, generating potential ''exploits'' Clever people in business sometimes amuse themselves by searching for such exploits, in order to give their firm a competitive edge.[10] The problem of ''creative'' accounting typically falls into this category as well (Blake et al., 1998, 25). Such ''gamesmanship'' is unethical.

Take the high road

One of the major problems with approaches to business ethics that ignore the adversarial nature of market relations is that they also tend to ignore the single most important excuse for unethical conduct in business. In a non-adversarial context, the fact that one person acts unethically does not in itself create any additional pressure on others to do so. For example, if one surgeon performs some unnecessary procedures, it does not necessarily give other surgeons a reason to do so. In a competition, however, the fact that one person is deriving an advantage from unethical conduct necessarily generates a disadvantage for everyone else, and therefore creates pressure for everyone to follow suit. Once one athlete starts taking steroids, it is very difficult for the others to stand by and do nothing. Acting ethically, in this context, means losing the competition. In an economic context, the consequences of ''losing'' can be quite severe. Of course, the mere fact that one is embroiled in a competition does not give one *carte blanche* to do anything whatsoever, just because the other person ''started it.'' One's *ethical obligation* is always to take the high road, and refrain from adopting any unhealthy competitive strategies. Nevertheless, it is important for business ethicists to recognize that managers, because of the competitive structure of the market economy, are systematically subjected to external pressure to engage in unethical conduct in a way that doctors, for example, are not. While these competitive conditions do not make it permissible to violate ethical constraints, they may provide a legitimate *excuse* for doing so (Austin, 1979; Baron, 2005).

There is one more general imperative that should be mentioned, which does not have a precise analog in sport. One of the more troubling features of the way businesses conduct themselves in the public sphere is that they consistently lobby against regulations that are designed to correct market imperfections (Baumol, 1974). For example, the petroleum industry fought vociferously against the ban on leaded gasoline, just as American automakers lobbied against mandatory seat belts, safety glass, catalytic converters, fuel economy standards, etc. This is, in a sense, doubly unethical – not only did these firms exploit market failures, but they dedicated considerable resources to entrenching these failures (even when there was only a marginal business case to be made for doing so). Thus, the fifth imperative might be, ''Don't oppose rule changes that have as their goal the correction of a market failure.''

Warren Fraleigh, in *Right Actions in Sport*, defines the ''good sports contest'' as ''one in which the personal intended ends of actions are congruent with or consistent with the purpose of the sports contest'' (1984, 49). The central claim here is somewhat subtle: the participants need not actually intend the larger purpose, but their intentions must be *consistent* with it. The same can be said with regard to competitive strategies in business. Managers need not intend the greater social good; they may adopt

competitive strategies with an eye only toward the maximization of profit. However, the strategies that they adopt in order to obtain profit must be *consistent* with the greater social good that serves as the "purpose" of the market economy, viz. efficiency in the production and allocation of goods and services. The imperatives outlined above represent an attempt to articulate the type of constraints that this sort of consistency imposes.

Naturally, the task of taking these very general conceptual templates and developing from them a set of more concrete moral norms exceeds the scope of this paper. I have sought to provide only a few suggestions. My primary goal has been to show that an adversarial approach to the ethics of market transactions – and in particular, an approach that preserves the old-fashioned idea that managers bear fiduciary obligations only to the owners of a firm – need not exhibit any sort of moral laxity, or provide an excuse for corporate misconduct. It should be obvious that the imperatives outlined above are extremely demanding, so much so that competitive pressures would probably prevent any corporation from respecting all of them in the near term. Thus, the adversarial approach presents an ethical ideal. The important point is that this *ethical* ideal is one that is consistent with *economic* ideal of the free market, and thus, far from being antithetical to the spirit of capitalism, can rightly claim to be articulating its true essence.

Conclusion

There is a reason why Sun-Tzu's *The Art of War* is a popular read among management and law students, but not among medical interns and engineers. The former are both preparing for professional roles within institutions that have important adversarial features, while the latter are not. Unfortunately, among management students, reading *The Art of War* is far too often seen as an *alternative* to the study of business ethics, one that offers more "realistic" advice for dealing with the challenges that will arise in the corporate world. In part, this is the fault of business ethicists, for having systematically failed to acknowledge the adversarial structure of the market economy. In their effort to stave off facile appeals to the "invisible hand," and to condemn the moral laxity that such appeals usually encourage, too many have chosen to deny the reality of competition, or to resist the suggestion that this competition offers individuals "immunity" from any of the norms of everyday morality. In so doing, they have failed to articulate the implicit morality of the market (or the implicit logic of corporate law), which is organized around the goal of promoting healthy over unhealthy forms of competition.

This has had a number of unfortunate consequences. First and foremost, it has encouraged the idea that when the market is producing bad outcomes, the way to improve it is to change the objectives of the participants. According to this view, corporations do bad things because they are too greedy in their pursuit of profit, so the way to correct this problem is for them to be less greedy, or to pursue other objectives besides profit. The adversarial perspective, by contrast, displaces attention from the objectives of the participants to the rules that structure the interaction. It suggests that rather than demonizing profit, ethicists should be encouraging firms to respect the "spirit" of the regulatory structure that governs marketplace competition. People who get hung up on the unethical nature of profit are essentially allowing the *pro tanto* immortality of a competitive strategy to obscure the overall point of the institution. In this respect, they are like those who condemn lawyers for "defending rapists and murderers" without looking at the role that a vigorous defense plays in an adversarial trial procedure.

The second unfortunate effect of the failure to acknowledge the adversarial structure of market transactions has been an inability to counter the widespread perception that business ethics is too "touchy-feely" to be of any use in the hard-nosed world of business. The adversarial approach to business ethics outlined here, by contrast, is able to distinguish between "playing hardball" – hard bargaining, nickel-and-diming, aggressive pricing, etc. – all permissible in a market context, and "sharp practices" or "dirty pool" – deception, cost externalization, creative accounting, etc. – which exploit market imperfections, and thus violate the spirit, if not the letter, of the rules under which marketplace competition is conducted. Business ethics, according to this conception, is not an alternative to *The Art of War*; it is more like a Geneva Convention or a code

of honor, a pact aimed at guarding against the almost universal tendency of competitive interaction, when left unsupervised, to degenerate into a race to the bottom.

Notes

[1] See, most importantly, Applbaum (1999).

[2] Thus Fraleigh (1984) is careful to distinguish between the "intended end" of participants and the "purpose of the sport contest," pp. 37–42.

[3] The model of marketplace competition presented here is similar to the neoclassical economic one, in that it posits two collective actions problems, one on the supply side and one on the demand side. (It differs in that it treats pricing decisions as the primary competitive strategy, whereas the standard neoclassical model represents individuals as "price-takers" who react to market conditions only by adjusting the quantity that they supply or that they purchase.) However, even in cases where there is very little competition among firms on the supply side, or among households on the demand side, one may see the emergence of what Galbraith (1952) called "countervailing power." In this case, a similar sort of competitive dynamic could be diagnosed, involving collectively self-defeating rent-seeking behavior on the part of increasingly oligopolistic agencies on both the supply and the demand side. In this case, the collective action problem exists between those on the supply and those on the demand side.

[4] For an excellent empirical survey, see Commission for Fair Play (1993, 34–38).

[5] See Leaman (1988). He gives the example of a tennis player constantly stopping to retie her shoelaces, in order to unnerve her opponent (p. 278). See also Steenbergen et al. (2001, 141–142).

[6] "Taking the low road" is sometimes referred to, euphemistically, as "evening things up" (see Commission for Fair Play, 1993). This suggests that violation of the rules by others generates a moral *permission* (perhaps even an obligation) for others to do so. According to the view developed here, it provides at best an excuse for doing so, never a justification (see Baron, 2005).

[7] Thus, stakeholder approaches to business ethics often involve a commitment to what Goodpaster (1991) refers to as a "multi-fiduciary" view.

[8] This is a consequence of the so-called "Second Best Theorem." See Lipsey and Lancaster (1956).

[9] See Friedman (1962, 1970). The latter, incidentally, contains a glaring example of the economic fallacy described above, in which 'as close as possible to perfect competition' is assumed to generate 'as close as possible to perfect efficiency' (1962, 120).

[10] Consider, the example, the actions of Enron traders gaming the California electricity market. See McLean and Elkind (2003, 264–283). An internal review of the practice generated the now-famous legal counsel that, "this strategy appears not to present any problems, other than a public-relations risk arising from the fact that such exports may have contributed to California's declaration of a Stage 2 Emergency yesterday" (2003, 277).

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