Adam Smith on management ethics: then and now

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Abstract
The paper concedes that Smith was as a pioneering contributor to debate on management ethics. The paper here traces management ethics in three regards: (1) managerial behaviour unintentionally yielding mutual gains outcomes for society; (2) law-following behaviour of managers reflecting intentional passive, ethical behaviour of manager; (3) managers creating ethical capital inside market exchange, this reflecting intentional active, ethical behaviour of managers. Smith relegated the latter from his program. In this respect I update Smith’s historic contribution to debate on management ethics, with a view to contemporary developments on many markets where we can witness management ethics inside market processes. Throughout the paper, I connect to economic theory, i.e. Smith’s Wealth of Nations but not behavioural ethical theory, which may see itself put in opposition to Smith from the outset. I view economic reconstruction and economic updates of Smith’s management ethics as essential to set out viable pathways for contemporary management ethics programs.

Keywords
Pioneers of management ethics; history of management ethics; Adam Smith; history of ethical capitalism; economics and ethics.
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To expect, indeed, that the freedom of trade should ever be entirely restored to Great Britain, is as absurd as to expect that an Oceana or Utopia should ever be established in it. Not only the prejudices of the publick, but what is much more unconquerable, the private interests of many individuals, irresistibly oppose it.

(Smith 1776/1976, 471)

Introduction
Should we forget history and ethics theory too as Jenkins (2009) defiantly advocates from a postmodern critical perspective? Can we still dare to historically trace a debate of management ethics, such debate going back at least to Dodd (1932), Mayo (1933, 1949), Bowen (1953), Drucker (1954), or McGregor (1960) (For recent reviews see Chong 2013; Schwartz 2007)? Can we even search for historical roots of management ethics theory outside management studies, as this is conventionally conceived? I take up this search by studying the economic texts of Adam Smith for ideas on management ethics, and how such retrospective analysis can contribute to mapping Smith’s ideas on contemporary management ethics theory and practice. Ultimately I take up the call for theory-grounded research on management history (Lamoreaux et al 2008; Rowlinson and Hassard 2013, 121).

Smith has been widely recognised as founding father of economics, but only more recently also of management studies (Crowley and Sobel 2010; Farmer 1997; Heames and Breland 2010; Koenig and Waters 2002). Surprisingly, in Wren and Hay’s (1977) early survey of management pioneers, Smith did not show up in the top twenty rankings. However, some thirty years later, in Heames and Breland’s (2010) survey of management pioneers, Smith climbed to rank sixth. Nevertheless, what has remained under-explored in a debate of Smith’s role in management history research is his input to a debate of management ethics. I then analyse Smith’s contribution to management ethics in relation to his economic writings: the Wealth of Nations. By doing so, my research sets out historical roots of a debate of management ethics through economic reconstruction.

I critically review the thesis, advocated by a considerable number of writers on management ethics (see below), that Smith’s economic writings, i.e. the Wealth of Nations, reflected an amoral or immoral approach, and hence needed to be conceptually buffered through behavioural ethics concept; for instance, even Smith’s (1759/1966) own behavioural, virtue based ethics, i.e. The Theory of Moral Sentiments. The frequent target of accusations is Smith’s model of self-interest as a key conceptual element of the Wealth of Nations. Without necessarily referring to management ethics theory, this argument is more generally debated by Adam Smith scholarship as the ‘Adam Smith problem’, that his two books may be difficult to reconcile in terms of ethics concepts (for a recent review see Wagner-Tsukamoto 2013). In this respect, I disassociate from the reconstruction of Smith’s approach to management ethics in non-economic terms; for example through behavioural ethics. I argue that the Wealth of Nations reflects conceptual and methodological ruptures.
as compared with behavioural ethics, including Smith’s *Theory of Moral Sentiments*; and that this has deep implications for assessing Smith’s stance on management ethics.

The paper addresses the question as to how we can associate ideas on management ethics with Smith’s studies. I set out the thesis that concepts of management ethics can be traced in Smith’s economic studies in three regards: (1) a mutual gains-from-trade program that yields not only intended benefits to those who exchange, but also unintentional benefits to society resulting out of economic exchange; (2) the systemic codification of ethics in institutional frameworks (e.g. business laws, constitutional structures), which induce law-following of managers, and constrain the way companies can engage in economic exchange; and (3) the creation and exchange of ethical capital inside market transactions. Not all of these ethics concepts were seen, neither by Smith nor by his critics. In these respects, my research contributes to not only positioning but also updating and expanding on, in economic terms, Smith’s concept of management ethics.

In the following, Smith’s contributions to management ethics theory are traced step-by-step. First, I review the mutual gains program of the *Wealth of Nations*, which in societal perspective reflects an unintentional ethics dimension of business activity. Second, I outline that the *Wealth of Nations* envisioned to institutionally, systemically constraining market participants (managers, firms, any stakeholder) especially through laws, enacting minimum ethical standards in this way. Third, I analyse how Smith’s approach to management ethics can be revised by examining how capital exchange on markets beyond the legally enacted has been infused by ethics. The latter updates Smith on management ethics; it yields a modern, instrumental stakeholder theory, and it demonstrates that an economic, instrumental approach to stakeholder management does not necessarily mean ‘business without ethics’, as critically reviewed by Goodpaster (1991, p. 53) and implied by others (see below). Fourth, the paper suggests that management ethics is difficult to establish for Smith by aiming to reconcile the *Wealth of Nations* with traditional behavioural ethics, even including Smith’s behavioural virtue based *Theory of Moral Sentiments*. The final part offers conclusions.

**Smithsonian economics and unintended ethics effects of managerial behaviour: self-interested, profit-generating management as management ethics**

Smith’s *Wealth of Nations* comes with normative, ethical aspirations. Already its title reveals this: the wealth of nations is the goal; universal and plural claims are at stake. The normative ambition is not the wealth of a singular nation, and even less so the wealth of a few individuals within a nation. Already Mandeville, prior to Smith, clearly realized this in his *Fable of the Bees*: ‘Private Vice, Publick Good’. This is their societal projection of a mutual gains program: market exchanges are to realize mutual gains at the two-party interaction level when capital is exchanged. Melé (2008, 58–59) for example, here projects Friedman to shareholder value theories of corporate social responsibility. However, they extrapolate this private mutual gains program in macro perspective regarding how private contracting is expected to have mutual gains effects on society – the ‘wealth of nations’ in Smith’s terms, or what Mandeville more ambiguously referred to as ‘publick good’.
The *Wealth of Nations* argues that already self-interested, profit-making behaviour, both of firms (managers; other employees) and of those a firm interacts with (consumers, investors, government, etc.), is to yield unintended mutual gains effects on society. Modern interpreters of management ethics and of the market economy sense this non-behavioural but systemic ethical position of Smith; Friedman (1962, 1970), Homann (1997, 1999, 2014) or Lütge (2005) being explicit. For instance, Friedman (1962, 1970) in the 1970s, put forward that the ‘only social responsibility [i.e. management ethics activity] of firms is to maximize profits [within legal constraints, as I discuss this latter issue below]’ – because of its wealth effects on society (Wagner-Tsukamoto 2007).

Abstractly seen, this mutual gains program implies a nonzero-sum model for the market economy. In Smith’s understanding, this legitimizes the market economy – the ‘greatest good of the greatest number’ and not of a few individuals (e.g. Smith 1776/1976, 455). He made many other references to this principle, such as the ‘wealth of nations’, ‘public happiness’, ‘happiness of mankind’, or ‘society’. They capture a societal ethics perspective, pointing at an economic business and society paradigm. This mutual gains program reflects economic growth for society and derivative ideals like the generation of employment; the innovation of more and better products and services; tax income for the state, which can be spent on the provision of public goods; rising living standards over time; etc. (see also Blaug 2008, 564-565). Smith’s famous invisible hand quotations can be referred to at this point (Smith 1776/1976, 456, 687).

Importantly, Smith stated that societal gains arose as unintended outcome or mere by-product of even merely self-interested exchange between two parties: ‘A revolution of the greatest importance to the public happiness, was in this manner brought about by two different orders of people, who had not the least intention to serve the public.’ (Smith 1776/1976, 418) Potentially merely self-interested profit-making of the firm is viewed in this reading as management ethics since this contributes through systemic ethics effects of the market economy for society. This happens ‘unintentionally’ when market participants exchange capital – Goodpaster and Matthews (1982, 136) calling this ‘independently’. Goodpaster and Matthews (1982, 136) move on to correctly characterizing this as the ‘systemic morality’ of the invisible hand in a market economy. Or Vogel (1991, 108, 114) hints at a ‘socially useful function’ of the market, or Watson et al. (1999, 86) more ambiguously speak of ‘social welfare as whole’, or Gerde et al. (2007, 14) referred to ‘individual gain’ yielding ‘benefits dispersed throughout society’. Nevertheless, it seems apparent though that neither Vogel (1991) or Goodpaster (1991, 53, 57–58, 60–61) see wider implications: As a conceptual consequence, strategic instrumental, self-interested stakeholder management of the firm can be reconceptualised as management ethics, by aligning it with unintended ethics effects on society that already self-interested exchange has. In part three of the paper I return to the latter point when discussing the market interaction level of managerial ethical behaviour, which differs from unintended systemic ethics effects of Smithonian economics.

In contrast, Allinson (2004, 18) doubted any unintentional systemic ethics effects of the *Wealth of Nations*. He questioned a mutual gains paradigm for the market economy, viewing it as ‘one man’s profit is another man’s loss’ and judging it as a zero-sum proposition that is ‘inherently unethical’ because of its profiteering,
‘selfish’ nature (Also Allinson 2004, 20; similarly Gramm 1980, 120, 131; Frémeaux and Michelson 2016, 6; Wolcott 2016, 5). In contrast, Smith explicitly stated that human nature in a traditional, moral behavioural and ontological sense (i.e. invoking virtue ethics; or similarly duty ethics, religious ethics, etc.) was not at stake when drawing on a model of self-interest for conceptualizing the market economy system and its ethics concept:

Whether this propensity [in human nature] be one of those original principles, of which no further account can be given; or whether, as seems more probable, it be the necessary consequence of the faculties of reason and speech, it belongs not to our present subject to enquire. (Smith 1776/1976, 25)


Smith, in the Wealth of Nations, made the transition from traditional behavioural moral philosophy, as still favoured by him in the Theory of Moral Sentiments (Smith 1759/1966), to non-behavioural, systemic moral philosophy, otherwise known nowadays as economics. Smith emphasized that the research problem within the Theory of Moral Sentiments is indeed the ontological study of human nature and of personal ‘private behaviour’, as he put this. He aimed to shed light on the nature of moral motivation. In contrast to this, the research problem of the Wealth of Nations deals with the question of how to organize economic activity in society. The latter required the methodological abstraction from behavioural ontological analysis of human nature, as Smith so strongly emphasised (See above).

Clearly, for Smith the Wealth of Nations was the continuation of ethics (Homann 1997, 1999) but a radically different kind of ethics emerged as compared with the Theory of Moral Sentiments. This change in ethics concept resulted from a change in research problems, research questions, research concepts, and research methodology. I return to this issue in more detail in part four of the paper when discussing the relationship between the Theory of Moral Sentiments and the Wealth of Nations, and what implications this has for contemporary debate on management ethics that aims to engage Smith.

The constitutional-institutional level of market morality: management ethics as law-abiding behaviour

Is there more to a concept of management ethics in Smith’s economic works than managerial behaviour that has unintended ethics effects on society? The thesis explored in this section is that Smith’s Wealth of Nations is to a very considerable degree not merely a treatise that advocates free market order and only links to
systemic, unintentional management ethics. Rather, the *Wealth of Nations* advocates free market order through institutional critique of the then prevailing economic system of Britain – the institutional structures of the mercantilist society. Critical questions in this respect are, first, whether Smith not only rejected mercantilist institutions but also advocated constitutional, institutional-legal reform and new structures that were to replace the ones of the mercantilist society. And second, if so, did Smith reckon a management ethics dimension of these new institutions, i.e. that law-abiding behaviour of managers and firms in relation to new constitutional and institutional structures of the market economy yielded management ethics inasmuch as laws codify and enforce ethical standards on the firm.

Unquestionably, Smith was an outspoken critic of mercantilist government and the way such government established institutional regulation through severe export-import restrictions, heavy taxes and duties of all sorts, monopoly powers that were granted to few producers, etc. (Smith 1776/1976, Books IV and V; also Skinner 1976, 1979, chap. 9). In this regard, Smith linked the sluggish growth and lacking economic progress of the mercantilist society to the specific institutional order this society had erected (See also North and Weingast 1989). In Smith’s (1776/1976, 530) assessment, mercantilist institutions were ‘unjust’ and ill-advised. He viewed them as ‘violations of natural liberty’ because they restricted economic progress (Smith 1776/1976, 530), as did they seemingly imply a zero-sum model of the economic organisation of society (e.g. Gates and Steane 2007, 4). Therefore he argued to abolish this order, and promote for free trade.

Nevertheless, it has to be critically asked as to whether Smith called for the advocacy of laissez faire economics, or whether he proposed to build a new constitutional and institutional framework for a free trade economy which, to a considerable degree, would cushion, regulate and indeed constrain trade. Reisman’s (1998), or early on Viner’s (1927, 218, 228–229) reviews are exemplary and very comprehensive in this respect (also Grampp 1948, 315, 336; Sobel 1979, 363, 365). Their reviews demonstrate that Smith clearly set out the role institutions should play in shaping economic growth and progress in a free trade society. No institutional-legal vacuum is left in this regard in the *Wealth of Nations*. For example, Smith argued for state activity explicitly in relation to national defence tasks, the administration of justice in society, and the undertaking of public works, i.e. the provision of public goods (Smith 1776/1976, 687–688). The ‘protective state’ (Buchanan 1975, 1987a; also Reisman 1998) is in substantial degrees set out.

With regard to justice tasks, Smith advocated various ethical principles which explicitly limited ‘natural liberty’ and free trade in a contextualized manner with regard to a specific industry sector: ‘The liberty, reason and happiness of mankind ... can flourish only where civil government is able to protect them.’ (Smith 1776/1976, 803; see also Reisman 1998, 367) Similarly, Smith (1776/1976, 324) raised the topic of market failures, specifically so for the banking sector: ‘Those exertions of the natural liberty of a few individuals, which might endanger the security of the whole society, are, and ought to be, restrained by the laws of all governments.’ (Similarly Smith 1776/1976, 112; also Jones 2010, 95; Wilson 1989, 63, 68–69) Or with regard to a specific country, Smith (1776/1976, 111–112, emphasis added) elaborated:
China seems to have been long stationary, and probably had long ago acquired that full complement of riches which is consistent with the nature of its laws and institutions. But this complement may be much inferior to what, with other laws and institutions, the nature of its soil, climate, and situation might admit. (See also Buchanan 1976, 274)

This critique of China, which argues for institutional change, compares to the one which Smith more extensively developed for mercantilist Britain.

Of course one could argue that Smith’s contextual approach to making qualifications regarding the regulation of free trade implies a general stance on limiting free trade because of the long list of context-specific constraints seen by him (See also Buchanan 1976, 271).

Furthermore, Smith put forward arguments for constraints on free trade in a non-contextualized, concluding manner in his critique of mercantilism, and these statements are even more revealing regarding his generalizing (institutional economic) theory building strategy. For example: ‘Every man, as long as he does not violate the laws of justice, is left perfectly free to pursue his own interest his own way, and to bring both his industry and capital into competition with those of any other man, or order of men.’ (Smith 1776/1976, 687, emphasis added; see also Werhane 1991, 2000, 195) A comparable, general qualification regarding laissez faire economics was made by Smith when discussing human capital:

The property which every man has in his own labour, as it is the original foundation of all property, so it is the most sacred and inviolable. The patrimony of a poor man lies in the strength and dexterity of his hands; and to hinder him from employing this strength and dexterity in what manner he thinks proper without injury to his neighbour, is a plain violation of this most sacred property. (Smith 1776/1976, 138, emphasis added)

The quotation at the beginning of this paper, which implies that purely free trade is utopian and even detrimental to society (Smith 1776/1976, 471), is equally general in tone.

These statements, both contextualized ones and non-contextualized, general ones, have strong institutional-legal connotations and they argue to constrain free trade. These few quotations and references should suffice to illustrate the considerable number of qualifications of Smith for restricting the free market. Buchanan (1976, 273) sums up:

Adam Smith was far too realistic to argue that markets would emerge and would function effectively in the absence of a legal framework. ... Smith ... avoided the mistake of assuming that property rights and contracts are secure in nature and that they could be preserved through the emergence of voluntary association.

Other analysts of the Wealth of Nations attest to this too, even critical ones. They agree that Smith’s Wealth of Nations put forward a surprisingly long list of arguments for institutional ordering and state activity in a market economy, thus constraining management through legal-ethical standards (e.g. Grampp 1948; Macfie 1967, 9; Musgrave 1976; Reisman 1998; Rothbard 1995; Sobel 1979; Werhane 2000;
Watson et al. 1999, 86; Wilson 1989). These reviews reveal that Smith cannot be considered to be a laissez faire economist. This is contrary to Nitsch (1999, 1316) or Wolcott (2016, 2, 23); and it is incorrect to suggest that ‘unlike Adam Smith, Bentham did not expect maximum happiness to occur without government intervention.’ (Wärneryd 1999, 89) Already Viner’s (1927, 228–229) discussion of many passages of the Wealth of Nations surpassed Bentham’s proposals on institutional regulation. Vanberg (2001) set out this argument for the economic constitutional governance of markets.

Having affirmed that Smith’s Wealth of Nations can indeed be read as an institutional economic treatise regarding the way economic institutions are advocated, the further question then arises as to whether Smith clearly realized a management ethics dimension of the new institutional order which he proposed for constraining of free trade. In contrast to previous institutional analysis of the Wealth of Nations, this latter question is central to the present paper: I do not focus on the question of whether Smith was an economic institutionalist as such but whether he was an institutional economic ethicist – who explicitly attributed to institutional structures of the market economy a management ethics dimension. Did he approach law-abiding behaviour of managers as ethical behaviour – as ethical precepts had been laid down in laws by society? For what purposes did he expect free trade to be constrained? Did he understand that constraining raised ethical standards in the market economy?

Later economic analysts of Smith, for instance Friedman (1962, 1970), comprehended this issue (Wagner-Tsukamoto 2007): First, Friedman’s economic analysis of management ethics or ‘corporate social responsibility’ of the firm captured the level of systemic ethics of the market economy – Friedman referred to this as ‘the social responsibility of firms is to maximize profits’. Second, Friedman explicitly discussed an institutional-legal concept of management ethics. He was outspoken about his belief that firms should only maximize profits within legal constraints as were these imposed by governments (e.g. already Goodpaster and Matthews 1982, 137 do attest this to Friedman).

Smith touched upon such a constructive ethical role of the institutional framework in enforcing ethical standards on market agents. For example, he spoke of the systemic role of governments regarding people’s earthly ‘subsistence in this life’ and their religious ‘happiness in a life to come’ (Smith 1776/1976, 539). He recommended that government intervention should ‘correct whatever was unsocial or disagreeably rigorous.’ (Smith 1776/1976, 796) A similar statement can be found regarding ‘consumer protection’ when Smith argues for quality seals for products (Smith 1776/1976, 138–139; see also Reisman 1998, 374) Smith’s (1776/1976, 324) statement on the legal prevention of market failures in the banking sector belongs in this category too (See above). Such contextual statements hint at historical roots of a management ethics theory that connects to concept of institutional-legal regulation. Yet, these ideas of Smith need to be deepened, generalized and projected to all kinds of economic activity for a fuller institutional theory of management ethics.

Market failures and externalities loom everywhere, and it has to be made clear that laws exist to fulfil an essential, institutional legal-ethical function in this regard. Economists connecting to the classical tradition of Smith are aware of this (e.g. Arrow 1973; Buchanan 1976; Friedman 1962; Novak 1996, 114). As noted, in
the Wealth of Nations this argument surfaces, although it is often presented in a sporadic and mostly, albeit not exclusively circumstantial, contextualized manner, with regard to a specific industry or group of society (see above). My review is more critical of Smith in this respect than Reisman (1998): It is undeniable that Smith gave a long list of examples for institutional change, regulation and state intervention. Nevertheless, an integrative, institutional economic theory is absent from the Wealth of Nations that set out management ethics concept in this regard. Such an institutional economic perspective on management ethics is required that explicitly promotes institutional ordering in order to enforce ethical standards on managers (and all stakeholders of the firm), thus protecting systemic morality (regarding unintended wealth effects on society).

Therefore, Smith’s approach to management ethics can be more clearly conceptualized. Certain updates on Smith’s institutional legal-ethical stance on management ethics become feasible. An explicit, coherent but not contextual, circumstantial and piecemeal theory of institutional legal-ethical regulation is required. In general, such a coherent, normative design-oriented institutional economic theory, which began to integrate concepts of ethics with economic theory, emerged only much later from the works of Buchanan and Tullock (1961), Buchanan (1975, 1976, 1987a, 1987b), and considerably also from North and Thomas (1973), Williamson (1985, 2000), North and Weingast (1989), North (1990), Ostrom (1990), Homann (1997, 1999, 2014), Vanberg (2001), Lütge (2005) or Lütge et al (2015). The current paper shifted such analyses towards the economic history of concepts on management ethics.

The market interaction level: management ethics as exchange of ethical capital

Smith was very well aware that the market economy commercialized or, to use terms of postmodern critical theory commodified or financialized exchange: ‘Every man … lives by exchanging, or becomes in some measure a merchant, and the society grows to be what is properly a commercial society’ (Smith 1776/1976, 37). The question then discussed in this section is whether and if so how Smith anticipated that capital exchange as such could commercialize ethics, and how this in turn affects our understanding of the history of management ethics theory.

The previously mentioned example of quality seals for cloth (Smith 1776/1976, 138–139) is relevant for beginning a debate on how exchange of capital can take on an ethical dimension. This begins to contest the classical view of Smith that market exchange as such occurred in the moral-free zone (merely constrained by institutional structures such as laws). The example of quality seals for cloth implies that it is not solely a law which enacts ethical standards for market interactions but also consumer choice is required in this instance: Consumers can choose a qualitatively superior cloth product by selecting one which has a legally approved quality seal. Choice is involved since consumers can opt to buy a product without a quality seal; such latter products can be expected to trade at a lower price. Apparently, the institutional level of regulation and the occurrence of free choice in market processes interrelate. However, Smith’s discussion of quality seals only refers to product quality issues in general but not to specific moral choices that consumers, investors, and other stakeholders could make through their capital dispositions.
Stakeholder behaviour here concerns not only capital exchange that involves market processes when purchasing a product or service but also any capital exchange process (within a firm; or crossing the boundaries of the firm).

Through ethical choice behaviour of stakeholders, capital exchange processes themselves can take on an ethical dimension — and management ethics then can be conceptually approached and practically enabled in a different way. Empirically, such ethical choice behaviour began to affect many economies since the 1980s, but the more so from the 1990s and after 2000. Such phenomena were not encountered by Smith and they were still unknown to Friedman (1962, 1970) or Arrow (1973) in the 1960s and 1970s when they commented from an economic perspective on management ethics and corporate social responsibilities. Even many later interpreters of Smith or of the market did not comment on these developments either (e.g. Bassiry and Jones 1993; Goodpaster and Matthews 1982; Jones 2010; Maitland 1997; Reinhardt et al. 2008; Tribe 1999, 629; Werhane 2000; Wilson 1989).

Such ethical stakeholder behaviour relates to many types of capital exchange, e.g. the exchange of environmentally friendly, fair trade, organic, free range and animal friendly products and services (Baron 2001; McWilliams and Siegel 2001; Schmelzer 2010; Smith 2008; Wagner 1997; Wagner-Tsukamoto 2007). These types of products and services are nowadays offered in many markets and have entered the mainstream in various categories.

From an institutional economic, ethical perspective, such choice behaviour of stakeholders is so fascinating because it raises ethical standards inside capital exchange processes. The standard of ethical behaviour we then observe on markets is higher than the minimum ethical standards that are institutionally enacted on all firms through structures like business laws or constitutions. Seen from the point of view of the firm, this phenomenon can be approached as the creation and exchange of ethical capital: A product or service is created which exceeds the minimum ethical standards laid down in institutions such as laws. Premium pricing may be necessary to cover higher costs that come with the creation of such capital; the reason being that the firm’s catering for ethical demand of stakeholders often is more costly than conventional behaviour (which only adhered to legal standards enacted in a market economy). Otherwise, the market process could be expected to automatically default to a more ethical level of corporate behaviour, and in this case the need to debate management ethics and corporate social responsibilities would not exist.

Ethical capital creation can be management-led, i.e. managers developing a market segment of ethically aware consumption, investment, employment, etc. Historically, the Body Shop or Café Direct internationally succeeded in this regard. The creation of ethical capital can also be driven by the market, management taking on a more reactive role, for example, responding to rising green consumer demand over time (e.g. Baron 2001; McWilliams and Siegel 2001; Schmelzer 2010; Smith 2008; Wagner 1997). Therefore, I can critically question suggestions such as that ‘demand is not ethically driven’, as Allinson (2004, 14) put this, and as Smith, Friedman, Arrow and many more implied or overlooked this. Significantly, ethical stakeholder behaviour yields ethical demand inside capital exchange, thus affecting managerial behaviour. In a sense, ethics is then ‘commercialized’, as Smith may have put this.
The management ethics theory we are arriving at in relation to stakeholder management is a conditional and hypothetical one: Only if a firm can profitably create and satisfy sufficient demand for ethical products and services (such products and services exceeding legal standards), can the firm begin to trade ethical capital with such stakeholders. This implies an instrumental strategic framework for stakeholder management, which can be moral philosophically grounded in social contract economics (for recent reviews, see Homann 2014; Lütge 2005; Lütge et al 2015). However, this kind of stakeholder approach is difficult to link, on the side of the firm, to Kantianism, virtue ethics or religious ethics, including Smith’s (1759/1966) own brand of virtue ethics-based theory, because of the pure, motivational and ends-oriented nature of these latter types of ethics concepts. With regard to these types of behavioural ethics, and these types only, we have to uphold Goodpaster’s (1991, 53, 63-65) criticism that traditional (behavioural, motivational and conscience-oriented) ethics when being transferred to the firm, yields paradoxical incompatibility or incommensurability: either ‘business without ethics’ or ‘ethics without business’. Macfie (1967, 5–6, 10) developed a similar conscience-based critique of the Wealth of Nations, and Vogel (1991, 114, 117), speaks in a similar vein of ‘paradoxical indifference’ of Smithsonian agents (similarly Heilbroner 1982, 427–428; or Tribe 1999, 620; or Witztum 1998, 510 on ‘Mandeville’s paradox of “private vice, public good”’). Parker (1998, S35) also referred to paradoxes within business ethics research, critiquing them from a postmodern perspective. And there is the wide-ranging debate about the ‘business ethics oxymoron’ (e.g. Bartlett and Preston 2000; Collins 1994; Nash 2000; also Duska 2000, 124). They all refer to the supposed infeasibility of ethically reconstructing instrumental stakeholder management and profit-oriented management.

However, such paradoxes and oxymorons do not occur throughout all kinds of ethics theory: a utilitarian, social contract economics is an exception. A coherent theory of management ethics, which can continue Smithsonian economics and his implied approach to management ethics, can be proposed. The conception of ethical capital is here foundational to update Smith on management ethics, embedding stakeholder management theory in economic ethical reasoning. This is so since ethics theory, which focuses on utilitarian, social contract economics, is means-oriented and consequential. Therefore, ethical motivations, intentions, attitudes, etc. of managerial behaviour do not matter for assessing, in an outcome-oriented, instrumental manner, the ethical nature of management intervention and the effects it has on an economically read social contract.

This leads on to a fundamental economic qualification of Smithsonian management ethics and how we can continue Smith’s historic project: The market process itself takes on an ethical dimension and market interactions are no longer stuck in the moral-free zone, which was ethically only constrained by institutional structures like laws. These updates do not reject but update the Smithsonian economic program on management ethics. For instance, the conceptual mechanism of self-interested choice is not dispensed with; especially not so for the firm; capital exchange still is place within a mutual gains program; or the idea of commercial exchange is not given up, when ethics is indeed commercialized and enters capital exchange.
Updating Smith on management ethics by reconciling the *Theory of Moral Sentiments* and the *Wealth of Nations*?

Both among Adam Smith scholarship and among management ethics research widespread attempts have been made to read an ethical stance into the *Wealth of Nations* by drawing on moral behavioural ethics theory, i.e. virtue ethics, Kantianism, or even Smith’s behavioural ethics, the *Theory of Moral Sentiments*. My argument is that such attempts can be contested.

First, Smith himself did not refer once in the *Wealth of Nations* to his earlier, moral behavioural *Theory of Moral Sentiments* (Berry 2003, 185). This should alert moral behavioural analysts of Smith who critique the *Wealth of Nations* through unrestrained and unquestioned references to the *Theory of Moral Sentiments*, claiming that the *Wealth of Nations* was an implication of the *Theory of Moral Sentiments* (e.g. Abela 2001; Brown and Forster 2013; Gonin 2015; Heilbroner 1982; Jones 2010, 94–95; Khalil 2002, 675–692; Macfie 1967; Reisman 1998, 358–370; Werhane 2000, 192–194; Wilson 1989, 69–70; Windsor 2006; Witztum 1998; Wolcott 2016; Young 1992, 72–73, 77–78). Where should we find this implication? The question is why did Smith not refer to the *Theory of Moral Sentiments* in the *Wealth of Nations*? Obviously, Smith could not have forgotten the *Theory of Moral Sentiments* by the time he wrote the *Wealth of Nations*, especially so since he published new editions of the *Theory of Moral Sentiments* after the first publication of the *Wealth of Nations* in 1776.

Second, the answer I want to suggest to why Smith ignored the *Theory of Moral Sentiments* in the *Wealth of Nations* is that Smith was aware that the two studies did not conceptually connect to each other, that they (a) addressed fundamentally different research questions and research problems; (b) they applied different theory-building strategies and different methods (in order to analyse different research questions and research problems); and (c) they developed, as a result, different ethical theories. In consequence, the two books have irreconcilable implications for a historic debate on Smithsonian ethics. This issue relates to conceptual and methodological matters as to how different social sciences could be integrated or not; for instance, by Buchanan and Bryman (2009, 4) when they warn of ‘paradigm soup’; or by Suchanek (1994) or Homann (2014) who discuss the ‘problem of theoretical integration’ of different social sciences.

Smith (1759/1966) clearly defined the research questions and research problems of the *Theory of Moral Sentiments* as a study in human moral motivation, targeting the sympathy-based and virtue-based analysis of personal, private human character. The subtitle already reveals this: ‘What are the principles by which humans naturally judge conduct and character of neighbours and themselves?’ (Smith 1759/1966, iii) He further specified these ontological questions of the *Theory of Moral Sentiments* as: ‘How do features of personal, virtuous character and the human mind stir moral motivation and human character?’ (See also Skinner 1979, 13, 16) The research objective of the *Theory of Moral Sentiments* is, as its title states, to set out a *theory of moral sentiments*, which Smith arrives at in its final part (VII). Smith (1759/1966, 391–2) then explicitly specified the research questions, and thus the research problem of the *Theory of Moral Sentiments*:
First, wherein does virtue consist – or what is the tone of temper, and tenor of conduct, which constitutes the excellent and praiseworthy character, the character which is the natural object of esteem, honour, and approbation? And secondly, by what power or faculty in the mind is it that this character, whatever it be, is recommended to us? ... How [does the mind] ... denominate the one right and the other wrong?

He questioned in this connection (Smith 1759/1966, 391–392, 472–480; also 451–460) that the idea of ‘self-love’ (i.e. self-interest) is to be conceptually drawn upon to examine ethical problems that concern human character and human moral motivation. In this regard, as noted by Khalil (2002) or similarly Gonin (2015), Smith is indeed a non-modern thinker – but Khalil or Gonin then transferred this argument from the Theory of Moral Sentiments directly to the Wealth of Nations (see below). This appears inappropriate as it was only in the Theory of Moral Sentiments that Smith set out a comparatively traditional, non-modern ethics theory, which was grounded in the empirical ontological method of character study, in the Greek virtue ethics tradition.

In difference, the Wealth of Nations’ research questions and research problems focus on the study and organisation of economic activity in society, in macro perspective, particularly, to paraphrase Smith, as to how a society’s revenue may be explained that provides the annual consumption (wealth; growth) for a people in different ages and nations? (Smith 1776/1976, 11) As Crowley and Sobel (2010, 504) put this: ‘Why are some nations rich and others poor?’

Methodologically, the Wealth of Nations is grounded in the non-empiricist Newtonian method rather than the empiricist Greek method. Smith (1762–63/1983, 145–146) was quite explicit in this regard (Wagner-Tsukamoto 2013; also Farmer 1997, 253; Schliesser 2005, 704–705; Skinner 1979, 35). Specifically, Smith applied in this connection the model of self-interest (homo economicus) to consistently analyse any human behaviour – including all organizations, small or large, all types of contracts, and all types of principal-agent relations – in terms of societal effects on mutual gains as interaction outcomes (the ideal of the wealth of nations; economic growth; and derivative ethical ideals). The normative goal of this approach is ethical, but it sets out a distinctively different and new ethics as compared with the Theory of Moral Sentiments. In this reading, it is above all the Wealth of Nations that sets out the corporate context and has implications for management ethics. I outlined various concepts of this type of management ethics and further derivative ones could be added (See Wagner-Tsukamoto 2003, chap. 8).

For these reasons, I argue that it is conceptually and methodologically naïve to critique the Wealth of Nations by aiming to merge it with the Theory of Moral Sentiments. Clearly, the Theory of Moral Sentiments and the Wealth of Nations can be compared with each other but the purpose would be to understand their differences, in theoretical, methodological, and normative terms, rather than somehow aiming to equate their conceptions of ethics and human morality and to blend one book with the other.

Essentially it is a shift in method, which relegated a model of human nature to the methodological, heuristic sphere that enabled Smith and similarly Mandeville to pioneer new ethics: The key feature of this new brand of ethics was that it did not conceptually or practically rely upon good moral human nature to create desirable
outcomes for society. In a sense, it discarded ontology of human nature: ‘I have never known much good to be done by those who affected to trade for the publick good’ (Smith 1776/1976, 456). Buchanan’s (1987b, 62) arguments expressed similar views (see further quotes above). The implications for historic and contemporary studies in management ethics are manifold.


Smith’s own understanding of this fundamental issue took some time to fully mature, indeed initially he also struggled with this insight, particularly when he attacked Mandeville in the Theory of Moral Sentiments (Smith 1759/1966, 451–6). To some extent, this attack can be justified since in the context of the Theory of Moral Sentiments Smith developed a behavioural study of virtue and sympathy-based, private moral motivation, which differs from his research problems in the Wealth of Nations. Smith’s attack was also provoked by Mandeville: Mandeville put forward his arguments on self-interest in a comparatively empirical behavioural, non-heuristic manner. Smith, unlike some of his interpreters (e.g. Macfie 1967, 5), later saw through this methodological self-made misunderstanding of Mandeville’s, that a model of self-interest was indeed not an empirical behavioural, ontological concept of economics that somehow depicted human character (Homann 1997, 18–19). This methodological insight helped Smith to advance Mandeville’s initial contributions (see also Buchanan 1975, 36, 170–171; Goldsmith 1988, 604–5) and pioneer an approach that we now know as economics.

The Wealth of Nations reflects, so my argument, deep conceptual and methodological ruptures as compared with the Theory of Moral Sentiments. Viner (1927, 201) early on touched on this issue. Interestingly, Gonin (2015) traced various ‘disembedding factors’ that in sociological terms, as he argued, since the 18th century grew the distance between Smith’s entrepreneur and the modern corporation. On this basis, however, he claimed an increased relevance of Smith’s Theory of Moral Sentiments for the modern corporation: connecting the firm to and buffering it through traditional, virtue-based behavioural ethics. In my view, the rise of ‘disembedding factors’ yields the opposite conclusion, namely that an approach to management ethics that continues Smith’s economic program moves away even further from the Theory of Moral Sentiments. Hence, one needs to search for concepts that can ground management ethics in Smithsonian economics connecting to (a) the ideal of unintentional mutual gains effects on society, which self-interested managerial behaviour yields; (b) the organisation of minimum ethical standards through institutions like business laws and the law-following of managers they are to induce; and (c) the creation and exchange of ethical capital through instrumental
stakeholder management (conceptually and ethically grounded in utilitarian, social contract economics).

**Concluding remarks**

It is important to trace a program of management ethics that emerges out of Smithsonian economics since it is the *Wealth of Nations* that sets out and legitimizes in conceptual, practical and normative terms not only the market economy system but also management activity within this system. I attributed management ethics to Smith in various regards, which in practical terms sets out three pathways for managerial ethics.

First, in Smith’s model of the economy, societal gains are to arise. This happens as an unintended systemic side effect of economic exchange. In this regard, even self-interested and solely profit-driven management yields management ethics since management contributes – unintentionally – to society prospering (wealth and growth; consumption; employment; innovation; tax payments; rising living standards; etc.). A mutual-gains-from-trade program is at stake and not merely ‘profit making’ of the firm. Management ethics programs need to discuss the systemic morality of the market regarding these unintentional ethics effects of even self-interested managerial behaviour on society.

Second, although trade as such occurs according to the classical economic vision of Smith within a moral-free zone, Smith knew that the exchange of goods and services is to be constrained by constitutional, institutional-legal and quasi-legal structures. Management ethics is in this respect, as Smith was aware of this, transferred into laws and other structures of institutional ordering. In this way, an institutional level of moral standards above a zero-level is enacted on managers and organizations (they being properly incentivised). In this reading, institutional and constitutional structures can be viewed as the conventional, standard location of management ethics in a market economy system, leaving capital exchange as such in a moral-free zone.

Third, more recent developments, especially since the 1980s, but more so since the 1990s and after 2000, have given rise to management ethics inside trade when capital exchange takes place. Practical examples are green, environmentally friendly consumption or ethical investment. Such empirical phenomena were not anticipated by Smith and they were not yet seen by classical and neoclassical economists (like Friedman, Arrow, and so on), as recently as the 1970s. In this regard, the classical economic approach of Smith to management ethics, as of his followers can be critically updated. Here, I connect management ethics to active intentional, ethical managerial behaviour. The implied commercialization of ethics as ethical capital, which is traded on markets, was not seen by Smith; yet, this continues Smith’s program.

Therefore, revisions to concepts of management ethics are undertaken on economic grounds. I proposed an instrumental strategic economic framework for management ethics and stakeholder management, which is conceptually grounded in social contract economics. Then, management ethics programs can surpass levels of ethics that are enacted through institutional-legal constraints. The viability of this program rests with ethically committed stakeholders who are prepared to pay a price premium for a product or service which is more ethical than a comparable,
of management ethics stance of Smith by projecting his behavioural *Theory of Moral Sentiments* onto the *Wealth of Nations*. I argued that deep conceptual and methodological ruptures can be observed between the two studies of Smith. Attempts to evaluate Smith’s management ethics need to take account of these ruptures, which drove the Scottish Enlightenment’s vision of modernity. This yields a fuller appreciation of Smith’s pioneering, economic contributions to management ethics.

In consequence, conceptual clarifications become feasible for behaviourally oriented management ethics theory; for instance, for Goodpaster’s (1991) suggestions on the business ethics paradox; Carroll’s (1979, 1991) pyramid concept of social responsibilities of managers (including its revision by Schwartz and Carroll 2003; see also Buchholtz and Carroll 2008); virtue ethics-oriented or Kantian stakeholder management theory (e.g. Evan and Freeman 1995; Goodpaster 1991, 67–68, 70); or Parker’s (1998, S28, S31, S35) suggestion that postmodern management ethics that aims to link to the ‘bottom line’ is an unfeasible bridging act. The current paper here then set out three pathways to management ethics.

Implications emerge for the theory and practice of management ethics. Case studies on the practice of management ethics are needed. For developing historic case studies, the practice of management ethics can be investigated as it is documented in corporate archives or in the business press of the time: We know that companies like General Electric or Johnson & Johnson already in the 1930s and 1940s began to aim at ‘constituencies’ (Preston 1990) other than shareholders, which we nowadays might call stakeholders. Similar developments occurred in the UK even earlier when Quaker companies like Rowntree or Cadbury began to engage employees in corporate decision-making and corporate welfare programs (Smith et al 1990). Why did they do so, already then? Can economic reconstruction of managerial views about management ethics shed light on this? Case studies need to look at historic context, in terms of time period, industry sector, country, etc., in which we can observe the early emergence of stakeholder management and stakeholder ethics and how and why this was viable then.

Further research on the economic history of management ethics theory is necessary. How far do the studies of management ethics pioneers like Dodd, Mayo, Bowen, Drucker or McGregor reflect on ethics concept of Smithsonian economics? Or, do their studies reproduce what Adam Smith scholarship has termed the ‘Adam Smith problem’ – the attempt to rationalize and ethicize economic concept through comparatively traditional, behavioural ethics theory? Can we historically trace in their studies the early estrangement of academic debate about management ethics from the then practice of management ethics?
References


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