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The Limits of Strategic Rationality: Ethics, Enterprise Risk Management, and Governance

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ABSTRACT. This article explores the links between strategic goals, enterprise risk management, and ethics. We offer a typology of managerial attitudes toward strategic goals and rationality and explore the interaction between strategic and ethical decision making. In so doing, we offer a practical framework for managers to approach ethical dilemmas in the highly complex, volatile, and risky economy that we currently find ourselves in.

KEY WORDS: decision-making, enterprise risk management, ethics, strategic management

Introduction

There has been considerable debate among both academics and managers concerning the purpose or goals of the firm which contrast the more narrow economic demands of shareholders to maximize the value of the firm with meeting demands for ethical behavior and/or the public good, often discussed in terms of stakeholders. There has also emerged an intriguing middle ground that demonstrates how managing for the public good can lead to enhanced shareholder value. Paradoxically, we believe that all the above accurately reflects different aspects of modern managerial reality and attitudes.[1] We believe that while there is much discussion about the issues and conflicts, there has been less effort put into considering the meta-context in which the debate is taking place. This is unfortunate because it has the effect of forcing a complex debate into a binary context which is far too limiting to be of theoretical interest to academics or pragmatic interest to practitioners. We will argue that basic managerial decisions force a consideration of ethical values and in many cases cannot be resolved without explicitly adopting an ethical stance.

Greater attention needs to be paid to the issues of strategic goals, risk assessments related to stakeholders, boundaries between public and private concerns, and managerial decisions. More specifically, researchers need to explore under what circumstances an ethically sound and/or socially conscious strategy might deliver superior economic results and under what circumstances are ethical or social goals in conflict with economic rationality. In our view, this fundamentally leads to an understanding of the attitudes toward goals and rationality. The issues facing modern managers are highly complex, volatile, and risky.[2] We believe that most practicing managers are all too aware of issues of corporate social responsibility (CSR) and ethics, but have not received sufficient guidance from theoreticians on how to discuss or explore the issues, let alone solve them. This article explores the links between strategic goals, enterprise risk management, and ethics. We offer a typology of managerial attitudes toward strategic goals and rationality and explore the interaction between strategic and ethical decision making. In so doing, we offer a practical framework for managers to approach ethical dilemmas.

A typology of managerial attitudes toward ethical and CSR issues

In the academic literature, there is considerable discussion over the role of managers in increasing shareholder value, and there can be no doubt that most managers in public firms feel considerable pressure to increase shareholder value.[3] Recent

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corporate scandals ranging from Enron to Parmalat have changed the expectations of not only shareholders, but also key stakeholders ranging from public policy makers to (potential) customers and suppliers. Clearly, all firms living in the Sarbanes-Oxley (SOX) world confront the new realities, but not all have recognized the strategic importance of the shift in expectations and the reasons behind the shift. In order to understand the realities facing organizations – both public and private – we need to understand the linkage between goals and rationality as shown in Figure 1.

We would like to tie these attitudes to how both shareholders and stakeholders can assess *ex ante* the reaction of these firms to challenging situations. We will start our discussion with the relatively classic position of Cell 1, and then move to Cell 2 to further our analysis of the implications for the single goal firm or organization. We will then move on to a more complex consideration of the world of Cell 3 in which we will examine more deeply the alignment of strategy and ethics in which ethics pays before elaborating how a process of enterprise risk management is needed to implement this strategy. We will then move on to how the limitations of economic rationality is revealed by the practice of ERM and set the stage for managing in Cell 4.

Cell 1 is the classic financial economic position recently presented by Sundaram and Inkpen.[4] This position has a long history and has grounded a great deal of important academic work with its stress on the singular goal of the firm matched with the power

Goals			
	Multiple	3. Economic Rationalist – "Ethics Pays"	4. "Good Citizen" - Undecidable
	Singular	1. Shareholder value Maximization	2. Advocate
		Singular (Economic)	Multiple
	Rationality		

Figure 1. Managerial attitudes toward goals and rationality.

of a singular economic rationality. As with many powerful, albeit simplistic, frameworks it also leaves us problems in terms of practicalities, such as "externalities." The classic response to the issue of externalities which may be closely linked to CSR in areas such as emissions and climate change is to define rigidly the boundaries between the responsibilities of civil society and those of the firm. Milton Friedman[5] perhaps captured this best. However, it should be noted that the corollary of Friedman's position is that social decisions are too complex to be left to businesses and that it is the role of civil society to establish the conditions under which businesses operate. This position has a certain pragmatic appeal because it lets capitalists focus upon what they do best while still achieving a just society. While we recognize that there are practical problems remaining with the power of firms to impact civil society, dealing with this important yet very complex issue needs to be left for another time.

Cell 2 is the realm of the Advocate who has a clearly articulated position on a specific set of issues. One could think the Body Shop or Stefan Marbury's Starbury basketball shoes which retail for $14.95 compared to $250.00 for some Nike shoes. While this position may also be profitable, the strategic logic is not driven by economics, but rather some other goal. The stance taken by these firms forces them to recognize the existence, if not the legitimacy of competing rationalities and goals. This would generally be tied to a niche or differentiated strategy where the firm's values can be readily identified by prospective market segments. One could equate this position with ethical positions driven by metaphysical, religious, or ideological concerns. There are no doubts here only certainty. The tie to a niche strategy immediately leads us to an issue with this position. Since there are many possible niche strategies, clearly the values are not universal and will find themselves in conflict with someone, somewhere, some time. This cell can lead to an interesting dialog with Cell 1 because while there may be issues with profit maximization, the potential for significant profits exist and because of the clarity (transparency) in communicating the strategic vision the firm may find willing shareholders, as the growth of ethical funds clearly demonstrates. On the other hand, in some cases, the refusal to maximize may mean that the firm or

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organization will seek niche investors, e.g., family or private equity, to accomplish its goals. If this is the case, then we should be concerned about the generalizability of managerial behavior presented by researchers in the tradition of Cell 1.

Cell 3 presents the rationalist who recognizes the existence of multiple goals related to CSR and ethics, but holds that a more enlightened or inclusive economic calculation or rationality reconciles strategy, profit maximization, CSR, and ethics. The rationalist is a more sophisticated or worldly version of Cell 1 and has been the focus of those in the ''ethics pays'' camp, e.g., Husted and Salazar, Porter, and Davis.[6] All organizations are based upon a value proposition which attracts customers and employees and implicit in this value proposition is a stance toward ethics. ERM is a necessary process for firms trying to pursue this strategy since if the strategy maximizes value, then the risk return structure of the strategy needs to be assessed. That is the risks need to be identified, measured, and priced. For that reason, let us turn to the process of ERM.

Strategy, enterprise risk management (ERM), governance, and ethics

ERM as a process of stakeholder management has not received adequate consideration in recent discussions of the goals of the firm. Assessing the performance of firms on a risk-adjusted basis has primarily focused upon Bowman's risk-return paradox.[7] While in the past, there may have been an attitude that shareholders can diversify away risk, recent corporate scandals and collapses have heightened the importance for sell-side analysts of being able to assess the risk management capabilities of the firm.[8] There can be no question that managers are concerned with managing both the volatility of earnings and value of their firms, if for no other reason than to maximize their own stock options. This has placed increased pressures on firms to disclose their risk appetites and profiles. Appropriate disclosure is neither possible nor credible without the appropriate ERM functions being performed within the company. Disclosure also helps to alleviate, but clearly not resolve, another ethical problem raised by the combination of the single economic goal and hegemonic economic rationality, the harm created to employees, suppliers, customers, and others who cannot diversify their risks. At least with better information, those stakeholders can make informed decisions.

The coupling of ERM with its holistic approach to aggregating and integrating risks has become a necessary complement to the strategic planning process and the one that is the most appropriate for calculating the risk/return structure of strategic decisions. At the risk of caricature, if we take strategy formulation to have the domain of identifying the entrepreneurial growth opportunities for the firm, we can then take enterprise risk management as the discipline which is concerned with properly pricing the risk associated with those entrepreneurial activities. While we recognize that modern risk managers are well aware of the art of their craft as well as the science,[9] for the moment let us stay with the science within the bounds of financial economic rationality.

It is important to clarify our use of ''risk,'' given its varied meanings. ''Risk'' is ''variation from the expected outcome over time'' and ERM as ''a decision-making process that manages variation from Company objectives.'' The likelihoods and consequences of this ''variability'' are not only the traditional losses but also the potential favorable outcomes and opportunities.[10] We would emphasize the proactive nature of ERM; ERM is fundamentally about preparing for the future more than creating a crisis response capability. In a business sense, ERM is about pricing products in such a way to protect the company from expected losses while having a capital structure that takes into account unexpected losses that drive the Costs of Financial Distress (COFD) without unduly punishing ROE. While this sounds straightforward in theory, the challenges facing CEOs, CFOs, and CROs is to find the balance point. Markets will not allow you to price in greater expected losses than your competitors and will punish firms that seek to hold excess capital in reserve against management mistakes. Competitive dynamics and capital efficiency render the appropriate pricing for risking a challenging proposition for those firms seeking to either address strategic issues with ethical dimensions or those who give primacy to ethical goal(s) in their strategy.

Shareholders and stakeholders are brought together in interesting ways by the interaction of strategy and risk. Modern risk management with its emphasis upon

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identifying risk drivers has come to recognize the importance of stakeholders.[11] The completely rational risk manager is well aware of the risks that can be identified, analyzed, and priced through a more detailed consideration of stakeholders. Unlike many financial risks, not all risks associated with stakeholders are not random and hence create the opportunity for learning and competitive advantage.[12] Just as firms need to know about stakeholders, clearly shareholders are also challenged with understanding how CEOs are identifying and managing the risks associated with their business. This brings us to the importance of disclosure policy in evaluating the creation of shareholder value. Disclosure provides the information that allows shareholders to assess the progress of CEOs to create shareholder returns in a risk-adjusted world and creates the opportunity for dialogs with stakeholders.

Without even considering the more abstract conceptual dimensions associated with the discussions, how is it possible to discuss the level of shareholder value creation without an understanding of the risks associated with it? Fallout from recent corporate scandals includes not only the demand for higher ethical standards from companies, but also greater skepticism and increased demands for the information necessary to assess behavior. Even as legislators may now be backing off on Sarbanes-Oxley (SOX), the political imperative to restore public confidence in the markets and restore legitimacy to firms should not be forgotten. Consequently, disclosure policies have become more important and hence can provide the opportunity to create competitive advantage or become a serious threat to the future of a company.[13] Ultimately, the degree of credibility that a company's disclosure will have will come down to how credible its statements are evaluated by different publics.

Some key activities of ERM include policy formulation, integration and aggregation, capital allocation, limit setting, and performance evaluation. Let us briefly discuss the strategic importance of each. Policy formulation sets the appropriate standards and procedures for dealing with the range of strategic and operational issues facing the firm. There is a strong centralizing force from ERM. Risk managers push for *ex ante* consideration of all external and internal issues that drive the risk profile of the firm. ERM aims at being both comprehensive and holistic. The goal is to identify all the risks that face the firm and just as importantly how these risks interact with one another. Recent attention to reputational risk makes clear how broad, strategic, and sometimes vague these risks are. As part of the process of managing to increase shareholder value, risk managers are involved in the capital allocation process to ensure that the individual parts of the business are profitable in a risk-adjusted sense. While most strategists would view growth as good in and of itself, the risk perspective is one that stresses balance in a holistic perspective. The example of Nestle selling formula in Africa helps to illustrate. In general, there seemed to be few problems with selling formula in the developed world where educational and infrastructure conditions made the product safe, if not valuable. However, growing sales in markets with different economic characteristics without appropriate safeguards was clearly problematic. This aspect of ERM demonstrates the close connection of ERM to both strategy formulation and implementation. It also demonstrates the non-linear nature of risk because what Nestle put at risk was not the incremental sales in Africa, but the entire operation as home markets responded negatively to Nestle's approach to growth in emerging markets. Performance evaluation, on the other hand, leads us to understand how central ERM is to the modern firm. It is virtually impossible to manage risk without employing the appropriate assessment tools and compensation techniques to reward employees on a risk-adjusted basis. Ultimately, many decisions affecting risk are decentralized. In fact, decentralized risk identification leads to a more robust ERM capability. Leading-edge ERM firms do not centralize all decision making, but rather seek to balance the forces of centralization and decentralization with limit setting and monitoring to allow for both efficient and effective decision making.

Strategy, ethics, and stakeholder alignment in the rational world

Many observers have commented upon the happy result when ethical and socially aware corporate strategies lead to superior strategic performance – the world where the Economic Rationalist strategist is

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both ethical and socially responsible. Figure 2 provides a matrix presenting alternatives as to how firms should act in ethically charged situations depending upon whether the proposed course of action is in alignment with their key stakeholders. For the moment, we are only concerned with situations; we are not concerned with prioritizing stakeholders or about conflicts with less valued stakeholders.

Cell 4 is where there is no conflict between doing what is good, what is strategic, and what maximizes shareholder value. While there is a vast strategic difference between whether the action is reactive or proactive, the outcome is a clear win for the firm. This may be Unilever in Indonesia or in a more developed market, HP actively campaigning to promote take back and recycling laws for the computer/home electronics industry. Not only is this a good thing in and of itself, but it also creates competitive advantage for HP over rivals whose value and logistic chains are not as well constructed to deliver in this dimension.[14] If the world always looked like Cell 4, the ethical or CSR conflicts facing business would not be as pressing and in fact would create as many opportunities as threats. The superior strategist would shape the markets based upon solid information in ways that were socially and ethically desirable. This is the cell in which the actions of the Economic Rationalist, the Advocate, and the Shareholder-Value Maximizer may coincide. It is ideally the world of the Good Citizen whose strategic commitments are unfettered by ideological commitment or doubts about the complexity of the future. This cell is the world of the visionary and those committed to disruptive change: the fuel cell maker Ballard, not Toyota the hybrid maker.

Ethical Situation		
Act	**3. Price of Differentiation**	**4. Responding to/Shaping the Market**
Don't Act	**1. Waiting For External Push**	**2. Missed Opportunity**
	No	**Yes**
Aligned with Key Stakeholders		

Figure 2. Strategic and ethical situations.

However, it is unclear to us how many situations truly resemble Cell 4. Cell 4 provides the dream situation for the economics-based strategist – the risks are identifiable, the costs are calculable, and the rewards greatly exceed the risks. This is the market situation that allows for extraordinary profits. While we dream of this situation, our suspicion is that the actual situation facing managers is more likely to be Cell 3. In this cell, we are trying to capture the firms that consciously develop a calculated strategy basing competitive advantage upon a superior ethical or CSR approach and accept that this approach will resonate with some market segments and impose costs that will limit the potential market share. Here, we might consider a restaurant that freely chooses to prohibit smoking to attract customers that value this. If this is in line with general social moves, this move could easily pay off big and render it a Cell 4 outcome. Our point is that we cannot envision a point that commonly offers such high returns in a risk-adjusted sense that would go unnoticed by most competitors. Clearly, it is the actions of firms that see the opportunities and close these market imperfections, but our suspicion is that they are far fewer and rarer than we would like or hope.

Cell 3 is also where the firm makes a clear choice to offer a value proposition in which it believes but one that leads to a product that will have features that make it less desirable to the broad market. One might think about Volvo's long-standing commitment to safety and how safety features may add to the cost of production, complexity of maintenance, and even an unattractive skin. For Volvo, insofar as safety is the dominant concern of an ethical car manufacturer, then safety concerns must dominate aesthetic concerns. This is not to say that aesthetic concerns are not important to Volvo, but rather to say that if a conflict exists, the safety concern will dominate. Over time, if the superiority of these features becomes apparent to the mass market (think of Suburu's advertisements featuring 4 wheel-drive), then the market will demand the feature and the firm will find itself well positioned for the happy world of Cell 4. In general, we believe that this is a more realistic strategic description of the way to achieve a leadership position, as the firm builds the capabilities and competencies needed to transform the market.

The world of Cell 2 is fairly straightforward in a world of strategic rationalists. The action may simply

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be outside what the strategy has set as its risk parameters. Or, the inaction may result from either inadequately understanding the potential returns from the situation or assessing the riskiness of the action as too high, that is, a strategic error. In fairness to these firms, it should be clear that the risk facing different firms is not the same as different competencies and risk capabilities alter not only the perception, but also the reality of risk.[15] This situation may arise because the firm is out of touch with its environment and is headed for failure.

Cell 1 in some respects may resemble Cell 2, except that there is no strategic urgency and there may be clear conflicts for either the Advocate or the Economic Rationalist. Unfortunately, the timetable that determines urgency is generally not under the control of the firm. The firm is putting itself at risk as it seeks to buy time and wait for external events to clarify. In general, we see this as a reactive position that may be rooted in causes ranging from perfectly legitimate concerns to lack of decisiveness. We believe that managers must remain aware of these situations and monitor them to be aware of when the situation morphs into Cell 2 where action becomes imperative. An obvious strategic tactic here is to employ real options to manage the risk return situation.

Strategy, ethics, and stakeholder alignment in the real world

The above section describes the world where the strategist can clearly calculate the risk and return of specific actions. Since March and Simon, it is clear that this is not the real world where managers have bounded rationality and ''satisfice'' rather than maximize.[16] We would like to make two points here before moving on. First, risk managers recognize the limitations to their approaches and hence make contingency plans for the unexpected. While they are highly rational, they understand that the quest for completeness would be an impossibility – this despite rigorously applying stress testing and scenario planning to come as close as is pragmatically possible. Consequently, risk managers try to anticipate the consequences of their limitations and put in contingency plans, business recovery plans, etc., to limit the adverse affects of the ''unexpected.'' We also wonder if managers schooled to understand that they can only ''satisfice'' rather than ''maximize'' might find themselves falling even further from the frontier than March and Simon anticipated. As theory makes explicit what was once implicit, researchers need to be cognizant of how behavior might change.

We just explored the situation where the rational decision maker simply cannot get sufficient information to make a decision and believe that key drivers of the uncertainty will clarify with time. Real-options strategy provides a robust strategic tool to manage in this situation. Now we want to address the situation where a rational decision is impossible because a single rational decision criterion does not exist and in fact the criteria are in conflict – this is the world of Cell 4 in Figure 1. This is very different from the limitations to rationality discussed by March and Simon. We would like to situate this in the very old tradition of logical sophisms and paradoxes that emerge when rationality is pushed to the extreme. Buridan's ass is the entirely rational donkey that is placed equidistant between two identical bales of hay.[17] Given the donkey's ultimate commitment to the value of rational thought, he/she is precluded from making a decision – the classis analysis paralysis – and ultimately starves to death although it is clearly in his interests to eat. While inaction may be the result of timidity, lack of decisiveness, etc., we also need to be aware of the dangers of purely rational thought when action is demanded. While the situation demands action, pure rationality alone cannot always provide the criterion. The donkey that ''irrationally'' attaches an additional value – survival – is the one that survives and prospers. We now return to Figure 2, but accept that there is an imperative to act, but a decision cannot be reached on purely rational grounds.

Let us start with Cell 4 again and reconsider HP and its CSR campaign but consider that the information needed to calculate the risk and return structure is not available, although the opportunity has been clearly identified. In order to make this more realistic, let us add that the key focus here is on sustainable competitive advantage and that HP realizes that its actions will be copied by its competitors in fairly rapid fashion and may ultimately lead to further demands that may increase HP's costs and lower margins. The Economic Rationalist will probably now make a different decision as

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uncertainty raises the riskiness, while competitive response reduces the returns. However, the Good Citizen and the Advocate will pursue this course because the decision is driven by values, not by calculation. These strategists clearly focus on the long term and recognize that ultimately the reputation of the firm that promotes ethics and CSR will eventually be challenged to make decisions that are costly at least in the near term.

The consideration of Cell 3 does not change much because the focus here was on firms that were value driven. What does change is that the degree of uncertainty makes it impossible for the firms to calculate whether the strategy is viable.[18] The only firms that benefit long term from differentiation strategy based upon values are the ones that clearly hold to those values. The important lesson from Johnson & Johnson and the Tylenol crisis was that consumers believed that Johnson & Johnson acted out of principle, not because they had calculated the best course of action.[19] In fact, if our presentation of the situation is correct, firms that act out of convenience on ethical and CSR issues face significant reputational risk when they are confronted with similar situations with unattractive payoffs. If the strategy is to be based upon credible actions, then the firm must be careful how it presents its strategy. Clearly, if the firm presents itself as opportunity driven to meet specific market demands, it would not face the same reputational issues. However, nor would it harvest much wanted positive publicity.

Let us return to the question that the skeptical consumer can ask of Volvo. Does Volvo value safety as the paramount value or does it become secondary to manufacturing an affordable car? Pragmatically, we realize that there has to be a trade-off, and we believe that this takes us into the realm of intent. Does Volvo consistently try to make the safest possible car within pragmatically determined parameters or does it seek to exploit higher profitability from its positioning as would be suggested in the normal strategy of differentiation? The perception of Volvo in the market place as either an ethically driven safety conscious company or one that is superior in recognizing and calculating the risk/return possibilities from an unserved market's demands for safer cars will be an important determinant of how its decisions are evaluated by different stakeholders. While we may applaud companies profiting from "smart" strategies, are they perceived as ethical companies or smart business people? Does it matter? We contend that firms that base their strategy upon values have to consciously articulate what issues they are compelled to comment upon. Volvo's stance of safety and CSR would seem to compel it to have a position on all auto safety issues and many green ones. The question then emerges how broad is the scope of the green issues that need to be publicly addressed. For example, is it imperative to embrace standards beyond Kyoto? Is it imperative to become involved in partisan politics not only in the home country but also in areas where you sell your product? Once you have crossed the line into areas of public policy, what criteria determine the boundaries between legitimate areas of concern and those that can be excluded.

In this context, Wal-Mart is an extremely interesting company. As the world's largest retailer and the largest employer in the US, it seems to have recently accepted that it must play a role in certain public debates, in particular, the environment and health care. Wal-Mart has recently embraced the green challenge with respect to packaging and is working with or demanding that its suppliers adapt new approaches in line with a greener strategy.[20] Perhaps more interesting is the role that Wal-Mart is playing in the health care debate in the US.[21] As one of the US's largest employers Wal-Mart has been subjected to significant levels of criticism for its approach to health care, especially by the Service Employees International Union for its compensation and benefits policies. Recently, however, Wal-Mart has joined with the Union in calling for affordable health care for all Americans by 2012. Wal-Mart's CEO. H. Lee Scott entrance into the debate and his position is extremely interesting: "Our current system hurts America's competitiveness and leaves too many people uninsured. We put aside disagreements to move this debate forward"[22] The real question here is what is the shape of the debate – or who is responsible for which aspects of health care, the private sector or the public sector. Perhaps, more correctly, what is the balance point between public and private responsibility. There is an intriguing dynamic to this debate to which we will return later – the fundamental point is that while there is logic on both sides about what should be done, Wal-Mart is compelled to act and not the least

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because of charges leveled against it. George Miller (D-CA) issued a report that claimed the following: "one 200-person Wal-Mart store may result in a cost to federal taxpayers of $420,750 per year – about $2,103 per employee."[23]

This leads us into a discussion of the dynamics of Cells 1 and 2. The health care issue is a challenging one because all agree that there is a problem, but the question is who is responsible. For Wal-Mart, the stakes are high, and it does not want to be in Cell 1 where an external push will force it to provide health care to its employees. If ultimately, it is decided that this is and should remain a private sector issue, then Wal-Mart may have missed an opportunity to lead the way for the private sector. The question for Wal-Mart is what will be the effect on future store locations, ability to hire the best employees, and possibly intangibles around its reputations as a leader. Wal-Mart clearly has stressed its leadership position and now that it has grown to the size it has, has it inadvertently inherited responsibilities beyond what its original business strategy considered? The demands from the public make clear that in the minds of some stakeholders it has. The question for Wal-Mart is to identify the challenges it must respond to maintain its desired reputation. Will the issue emerge that how can customers expect fair treatment from a company that does not treat its own employees fairly? We do not believe that the case for public health care in the US is decidable on strictly rational criteria – as the length and severity of the dispute suggest. However, we also do believe that the issues compels firms to act, and hence to make a decision. However, if we cannot decide solely on a rational basis, on what basis can we base our decision?

Ethics and the rationally undecidable issues

We can hear pragmatic managers arguing that there are no rationally "undecidable" issues so for that reason, we would like to expand upon what we mean by this term and explain how it links to the typology of observed behavior. For the Advocate, those guided by ideological or metaphysical norms (including religion), there are probably no important undecidable issues either. However, for those theoreticians and managers who live in the world of Cell 4, there is a profound difficulty with being a "Good Citizen" and that is the boundaries in which they seek to be a good citizen because the boundary conditions between business and ethics or business and CSR are complex, fluid and may be situation specific.

Our approach is based on undecidability[24] and action which clearly separates us from a number of other researchers who would argue that either metaphysically grounded norms or consensus-based values based in a social contract would make all situations "decidable." We would also argue that this oversimplifies the reality facing managers and the choices that they must/should make. Moreover, we argue that selecting one metaphysically based norm or one consensus-based social contract denies the collision of norms that is taking place both in liberal western democracies – pro-life versus pro-choice – and between the liberal west and more religiously based regions – secular versus religious, e.g., free speech versus cartoons of the prophet Muhammed. While there may be many issues that are "undecidable," we are especially concerned with situations that are both undecidable and strategic, because it is in this realm that managers must decide (act) and there are probable links to competitive advantage. Many managers in fact would stress that choosing the "right" norm is strategic, "undecidable," and imperative for many firms. We will argue that understanding why your decision is the right one is imperative in these situations since opposition will be inevitable and well founded.

Our approach to strategy and ethics leads to the following matrix shown in Figure 3 below which provides a schema for looking at the interactions between strategy and decidability and where the interesting issues are:

Let us discuss some real-life examples that populate Cell 4. There are important debates concerning what are matters of personal choice and what are matters of public concern. The divide between those espousing individual versus community-based values is real and of strategic importance. Whether the issue be smoking and second-hand smoke or the pro-choice versus pro-life debate, many companies are forced to choose between two positions that are irreconcilable and claiming to be ethically correct. Roughly 16 years ago, the Bank of Montreal was

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Strategic			
	Yes	3. Clear Path Forward	4. Strategic/ethical dilemma
	No	1. No issue	2. Not urgent – draw out – employ real options, alliances etc
		Yes	No
	Decidable		

Figure 3. Interactions of strategic and ethical decisions.

approached to become involved with an Affinity Master Card for a fundraising program for LifeCanada – a pro-life group. The bank eventually canceled the program and created considerable unwanted publicity when a Conservative MP, Maurice Vellacott, called for a boycott of the bank. The press release on lifesite.net clearly displays the dilemma facing the bank.

> "As a financial institution, we really can't and don't want to be involved in decisions that people consider to be personal and private," claimed BMO spokesman Ralph Marranca, who said the bank will not be renewing the 15-year program after its expiry in July. "We didn't want to be seen as taking sides in any way." Marranca admitted in April that only a "small number" of complaints had been received about the program.
>
> …
>
> Although Marranca claims the BMO decision is because abortion is a "personal and private" decision, the bank obviously does not have a problem with supporting embryonic stem cell research – the deliberate murder of embryonic children for financial reward. BMO also sponsors the Affinity MasterCard program for the Juvenile Diabetes Research Foundation which supports embryonic stem cell research. (http://www.lifesite.net/ldn/2005/jun/05061403.html)

Clearly, the bank was perceived as taking sides by some segments – there was no neutral position. It is important to recognize that even if the bank had turned down both sides, the problem would not have been resolved because denial would have been tantamount to a decision against – at least in the court of public opinion. The bank's decision to portray the decision as undecidable was not accepted by those with normative views, and its actions were taken as de facto decisions. The conclusion that we draw from this is that the undecidable must be decided and that the consequences on the reputation and the market strategy of organizations are imperative.

A second organization tried to deal with a similar conflict by noting that it was undecidable and then attempted to make it invisible. We are of course talking about the US military and the "don't ask, don't tell program." This program was created after President Clinton failed to end the centuries old ban against gays and lesbians in the military. While Clinton failed, the result was a law that clearly specified the privacy rights of those serving in the military – the hoped for result was that while de jure gays and lesbians were banned from the military, de facto they need not be. The point here is not to blame either the politicians or the army, but to show that the failure to recognize that the undecidable is precisely where ethics calls for a decision.

Some may wish to argue that the decision is really a strategic one and not a strategic and ethical one. One form of the strategy argument could run that the Bank of Montreal should decide on the basis which will satisfy the greatest number of profitable customers and that the military should seek to maximize its attractiveness to the right candidates. We will argue that this is to take an unfortunately technocratic approach to strategy. All organizations are based upon a value proposition which attracts customers and employees and implicit in this value proposition is a stance toward ethics. The stance could be purely technocratic and ethical. Alternatively, leaders could weigh whether to take a legal but albeit unethical position or leaders could see the importance of making their values explicit as a guide to decision making not only at the top but also throughout the organization. If the military is to defend all Americans, does it not have to decide upon which values are American. Is it ethical to create a system which precludes someone asserting their sexuality? We would hold that the failure to make the ethical decision has the effect of forcing others into possibly unethical positions as it forced gays/lesbians who wished to join the military to implicitly deny part of their being.

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Second, consider the Bank of Montreal. The Bank is involved with helping individuals to plan their lives by way of their involvement of financial planning. Should I as a customer expect to know what values the organization may hold because it could affect investment advice which I will be offered? We argue yes and while an older social paradigm may have held that we could be silent on important issues – "we don't talk about religion or politics" – in today's world how can we truly understand others if we do not understand the values which guide their decision making. Admittedly, not all members of any group slavishly follow its precepts, but should not the pre-conceptions of others be made transparent in order to create the possibility for dialog about ethics.

Another organization makes very clear the internal dangers to an organization of not clearly articulating the values essential to the identity of the organization in a global context. The Anglican Church – presumably an ethical organization – is facing possible dissolution over the roles of gays/lesbians and women in the Anglican Communion. The American Episcopalians (ECUSA) has been going their independent way since the mid-seventies when it unilaterally ordained women. The split between the US church and the global communion was truly brought to a head by ordaining the openly gay Gene Robinson bishop in 2003. The Bishop of Canterbury, the head of the Church, cannot resolve the issue, and the split is too serious to ignore.

> Instead of endlessly trying to paper over the cracks, the Archbishop suggested on June 27th, the communion could bread up into a core of "constituent churches" willing to sign a doctrinal covenant on homosexuality and other thorny issues and "associated churches" who would do things their own way, opting out of communal decision-making. (*Economist* July 1, 2006, p. 52)

Some might argue that the issues are decidable, but we would argue that the split clearly demonstrates the real-world problems of both metaphysically based norms and even efforts to develop a social contract. It is clear that there has been considerable good will to try and resolve the contentious issues, but the conflict is too basic to what constitutes ethics to both sides to compromise. The American church has to act if it wanted to be "ethical" according to its views, while the Africans had to act to be true to their more conservative views. While this geographic split over-simplifies a complex reality, the doctrinal split is real and driven by ethical decisions. The point we would like to emphasize is that globalization adds a whole new dimension to what is "undecidable" – especially, if western liberal values are recognized as being as ethnocentric as any other value system. This is not to say they are wrong, simply to say that their claim to hegemony will be increasingly under attack.

Conclusion

The question that organizations such as the Bank of Montreal and the American Military must pose is whether their decisions need to be determined by ethical criteria and whether they will be perceived as ethical. Both as a theoretical and practical matter, we assert that these are ethical decisions and the decision not to decide is equally an ethical one. The issue is becoming one of increasing importance because many organizations wish to portray themselves as "ethical companies" in at least some of their interactions. The question that must be posed is can you be a little bit ethical? By this, we are asking where are the boundaries – which are the ethical situations that the firm must decide upon to be considered ethical and which ones can/should it avoid. Strategically, the firm must choose whether to determine this for itself or to have criteria thrust upon it by dissatisfied customer, shareholders, and other stakeholders. We argue that the firm as a strategic decision must articulate its own ethical norms and the scope over which they hold sway and recognize that this may have to be an ethically based decision, not a strategically based one. This could also involve setting firm boundaries between what is the role of the private sector and what is that of civil society or the public sector.

Rationality cannot ground norms or values, it can only calculate the consequence of following such norms. To the amoral strategist, this is fine so long as the results are calculable, but what if the split is 50/50 or the symbolic price of either side is extremely high? More typically, what guides action in situations of high uncertainty that cry out for action and leadership? We argue that the firm must select the values that will guide its choice and be able

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to articulate its position in light of the kind of firm it is and wants to be if it is trying to seek any sort of competitive advantage from its ethics or CSR policy. If this is right, then ethics trumps strategy in a world where undecidable positions are a fact of life. In addition, this means that firms must articulate their ethics if they are to be credible on issues of social import.

Notes

[1] We are not alone in this observation, see Paine (2003), or Vogel (2006).
[2] See, for example, Gioia (1992).
[3] We prefer to talk about "increasing" rather than maximizing for pragmatic reasons.
[4] Sundaram and Inkpen (2004).
[5] Friedman (1962).
[6] Husted and de Jesus Salazar (2006). Porter and Kramer (2006), Davis (2005a, b), or Bonini et al. (2006).
[7] See Andersen et al. (2007). For a discussion of risk and strategy as opposed to the process of ERM, see Bromiley et al. (2005).
[8] The issue of risk diversification is actually more complex than this. For a revealing discussion, see Apgar (2006), Chapter 5, "Building Networks That Can Adapt to Risk," pp. 143–181.
[9] Samuels (2006).
[10] This comes from a presentation by Joanna Makomaski, Manager, Risk Management, at Enbridge Energy Distribution, Inc., Canada's largest natural gas utility, at 2006 International Risk Management Conference in Toronto, sponsored by the Conference Board of Canada and ably constructed by Diana Del Bel Belluz, a Canadian consultant and reported in ERisk on February 7, 2006.
[11] Clearly, this is only one aspect of governance, but the one upon which we have chosen to focus. See the number of references to stakeholders in one of the early texts on risk management with a management focus, Lam (2003).
[12] This is the key theme of Apgar.
[13] This was clearly demonstrated by Progressive Insurance Company who used a new disclosure policy to prove to markets that it was a superior risk manager.
[14] See Woellert (2006).
[15] See Apgar.
[16] March and Simon (1958) and Cyert and March (1963).
[17] The paradox actually has its roots in Aristotle.
[18] See Bromiley et al., op. cit., pp. 260–261. We are making use of Knight's distinction between uncertainty and risk where risk is equated to knowing the probability distribution of outcomes while uncertainty means that the distributions are unknown. In uncertainty, the rational science of ERM offers no hard answers.
[19] Alsop (2004).
[20] We are still not certain that Wal-Mart is a green company, but it is certainly greener than it was.
[21] See "Exchange" in *The Academy of Management Perspectives* 20:3 (August 2006), 6–43.
[22] Kris Maher, "Wal-Mart Joins Health-Care Call," *Wall Street Journal*, Thursday, February 8, 2007, p. A6.
[23] *Multinational Monitor* 25:12 (December 2004). http://multinationalmonitor.org/mm2004/122004/mokhiber.html.
[24] Author identifying note removed.

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