CHAPTER 1

Virtue Lost

INTRODUCTION

The dramatic rise[1] in corporate malfeasance and accounting-related problems since the enactment of the Sarbanes-Oxley Act of 2002 argues for the urgent need for substantive improvements in U.S. corporate governance policy. The demonstrated inefficacy[2] of the extant regulatory approach indicates the need not simply for revised policy, but for a revamped regulatory framework,[3] whose core assumptions about human behavior are more closely rooted in actual experience. However, progress in this critical policy arena has been severely hampered by multiple factors, beginning with a relatively hollow debate punctuated by a lack of effective policy dialogue[4]—one that appears to be at an all-time low. As a consequence, a rational basis—one quite difficult to achieve—for modern U.S. corporate governance regulation has eluded policymakers.[5]

A further obstacle has been the complex nature of corporate governance regulation: As rooted in a deeply embedded, philosophical history of ideas,[6] regulatory efforts cannot be adequately understood outside of the context of the distinctive moral and evaluative position that they represent.[7] Because modern policy analysis overly relies upon quantitative analyses, the "inescapably historical, socially context-bound character"[8] of regulation has been essentially overlooked. Thus, policy research has, to date, been able to contribute relatively little to the ongoing debate.

Furthermore, fundamental disagreements—for example, those concerning the normative role of corporate ethics, of governance regulation, or the responsibility of government to protect investors from corporate malfeasance—are inherently difficult to resolve, presenting another obstacle to regulatory progress. Consider that current differences over U.S. corporate governance regulation are no less than profound,[9] extending "even to the answers to the questions as to how to proceed in order to resolve those same disagreements."[10] Due to the inherent difficulties present, a rational basis for U.S. corporate governance policy has, to date, eluded policymakers, resulting in repeated regulatory failures.

Whereas this suggests an immediate need for a renewed policy dialogue, absent which policy failures can reasonably be expected to continue unabated,[11] even greater consideration must be given to the ultimate objective: developing a revamped policymaking process, thus permitting an efficient resolution of convoluted policy differences. Only a policymaking process that is thoroughly systematic and rational can effectively encourage an arsenal of efficacious policy.

Currently, attempts to resolve policy disagreements, in general, follow two distinct approaches: (1) a noted emphasis upon quantitative analyses[12] so as to acquire a set of sound arguments as needed to rationally justify a particular point of view, and (2) a sort of fideism, in which trust is placed in persons rather than ideas.[13] The first category is evidenced largely by a growing body of empirical evidence, which provides an effective demonstration of the fundamental weaknesses present in Sarbanes-Oxley–era regulation.[14]

The second category is readily witnessed in the particular brand of alarmist populism, as exhibited by leaders such as Arthur Levitt, which successfully propelled Sarbanes-Oxley—and later the Dodd-Frank Wall Street Reform and Consumer Protection Act—into law. The allure of fideism is most strong when the particular motive is self-interested gains[15]—for example, as for a particular group—as opposed to an objective interest in effective policy development. This has encouraged arguments over policy to be deployed as weapons rather than as fundamental expressions of rational interest,[16] a defining characteristic of the shrill debate over Sarbanes-Oxley–era regulation.[17]

Consider that opposing sides in the ongoing regulatory debate have all but dismissed one another as representing prerational "communities of faith,"[18] thus further widening any chasm already between them. The effect has been to render an agreement as to rationally justifiable conclusions—for example, regarding the normative and appropriate use of corporate governance legislation—all but impossible.[19] Thus, the two dominant approaches employed to settle regulatory differences in the modern era—for example, (quantitative) research and fideism—have failed, evincing not the slightest capacity to persuade the opposing side as to the particular merits of their own views.

The result is a debate more closely resembling a bog than a rational policy discourse: Whereas policy failures continue unabated, of even greater concern is the demonstrated lack of any rational basis.[20] Consequently, substantive efforts to extricate governance regulation from the policy bog have proven counterproductive—as suggested by the recent enactment of Dodd-Frank[21]—making matters worse rather than better.[22]

The present focus of this analysis is to encourage—by eschewing the frequent traps inherent in the highly polemicized debate over governance regulation—the very types of insights fundamentally necessary to facilitate regulatory progress. Consider that the primary objective of modern governance regulation is to reinforce the integrity of the corporate structure, essentially by reaffirming the basic principle of reciprocality—a specific issue that will be discussed subsequently in greater detail—upon which it largely rests. As this objective is more germane to ethics than classical economics—given that its focus is nonnormative—this study employs a novel approach to focus on an alternative, theoretical framework, one whose core assumptions may be more closely rooted in the human experience.[23]

A fundamental reliance upon a more efficacious, analytic framework is likely to: (a) result in an enhanced conceptualization of the underlying policy issues,[24] as needed to facilitate regulatory progress, while also (b) suggesting salient opportunities for substantive improvements to the regulatory framework. Given that the modern policy framework may be understood as lacking an adequate rational basis,[25] which has prevented the development of efficacious policy, the immediate focus of this analysis is more theoretical than it is pragmatic. Consequently, its emphasis is upon the development of broad, conceptual-level themes rather than narrow empirical estimates.

It is also decidedly optimistic, as derived from two general presumptions: (1) that "corporate ethics" is not a contradiction in terms,[26] and (2) that the widely documented failure of corporate governance regulation in the modern era is generally indicative of fundamental policy weaknesses, rather than the moral fragilities of those governed. The latter factor is important in that it infers hope, making possible the expectation for substantive policy improvements to yield propitious economic outcomes.

Due to the overriding ethical concerns of corporate governance policy, this analysis relies heavily on virtue theory, which may be traced back to Aristotle,[27] for guiding insight. Whereas modem philosophy—for example, Hume, Kant, and Mill—and Aristotle contradict one another, at times quite starkly, Aristotle is more relevant to this context for two reasons: (1) due to the prominent contribution he has made to the modern study of business ethics,[28] as well as corporate governance issues,[29] and (2) because his ideas have generally withstood the test of time, such that they are no less relevant today than during his era.[30] Currently, a formidable logjam is effectively blocking regulatory progress, largely due to a nonfecund debate between quantitative empiricists, on the one hand, and fideists on the other.

Hence, there is ample opportunity for an ancient philosopher—one representing a neutral party over whom neither camp may rightfully claim ownership—to encourage progress where others have failed. Consider that Aristotle's ability to effectively address the human condition—one that seems to be more or less time invariant—has been repeatedly demonstrated,[31] such that generously applying his time-tested wisdom and knowledge to a dysfunctional, nonfertile policy dialogue[32] is likely to offer significant benefit.

METHODOLOGY

As the introductory chapter, it is comprised of three interconnected segments. The first segment provides a broad, conceptual level introduction to the constituent ingredients fueling the extant regulatory debate. This includes an analysis—one whose focus is theoretical—as to the basic need for corporate governance regulation, in order to encourage an appreciation of the appropriate regulatory telos; a discussion of corporate ethics in the modern context, so as to engender a parsimonious understanding of ethical corporate behavior—for example, what it is, and what it is not; and an analysis of the corporate structure, per se, as a topic imbued with heated controversy, to determine whether efficacious corporate governance regulation constitutes a fundamentally realistic objective.

The focus of the second analytic segment is to revitalize the existing corporate governance policymaking framework. A fundamental premise of this study is that the widely documented failure of corporate governance policy in the modern era—for example, since Sarbanes-Oxley—is more generally symptomatic of a deeper underlying problem: an inadequate conceptualization of human behavior, especially as it pertains to the corporate context. This presumes that efficacious corporate governance policies will continue to elude policymakers until the policy foundation is thoroughly revamped.[33]

Particular emphasis in the discussion is given to considerations as to the role of virtue,[34] the application of rules versus principles, and of punishment versus amendment. This analysis seeks to develop rationally compelling insights—as may be derived through a fundamental reliance upon Aristotle—that possess a realistic potential to facilitate regulatory improvements. Consistent with the introductory focus, the level of analysis is broad and conceptual,[35] and thus is not immediately concerned with individual policy mechanisms.

METHODOLOGICAL LIMITATIONS

Despite the proposed advantages, specific limitations pertain to the methodology employed as well as to the subject matter. Whereas quantitative econometrics produce findings that are generally characterized as narrow but precise, the methodology employed in this analysis is analogous to that of an artist—one whose work richly illustrates, but which does not lend itself to empirical estimates of precision. Thus, the findings of this study cannot be demonstrated as conclusive, nor is it possible to directly assess their value relative to those that are potentially derivable from alternative frameworks. (Nevertheless, as a comprehensive treatise, nearly every major methodological framework is represented in this book).

As previously noted, the debate is particularly messy: Disagreements extend beyond regulatory matters, to include how each side characterizes the positions of the other, resulting in disagreements over disagreements.[36] This makes it theoretically impossible—no matter how prodigious the effort—to either approach the debate from a completely neutral perspective[37] or to faithfully represent each divergent perspective. (Thus it is inevitable that at least one side, as present in the policy debate, will consider their views as having been inadequately presented).

A related concern is that what constitutes progress—and how it is evaluated—is extremely subjective, and thus largely dependent upon whether the individual affiliation is as a Capulet or a Montague.[38] This is to suggest that, no matter how rigorous or compelling it may be, a single study (or even volume of studies) lacks a realistic capacity to remedy a policy rift that has festered for decades, despite having become more apparent only relatively recently, in the past decade.

Despite these limitations, corporate ethics remains the dominant concern of U.S. corporate governance regulation, and thus is ultimately concerned with values. As a result, the overwhelming complexity present cannot be directly evaluated with the same dry precision as might be applied to a leading economic indicator, or even to efforts to quantify GDP.[39] This is to suggest that the dominant policy emphasis upon quantitative methods—which by definition are value neutral—is severely contraindicated, and thus of relatively limited utility, a factor that has become salient in the last decade of pronounced U.S. corporate governance regulatory failures.[40]

However, hope remains alive: A three-dimensional conceptualization of the policy problem, as facilitated throughout the eclectic studies presented in this book, has a unique opportunity to inform policy, in part by emphasizing the fundamental and inexorable (causal) link that unites a logical policy framework to a rational and deliberative policymaking process,[41] and finally to the development of efficacious policy.

THE MODERN CORPORATION AND VIRTUE

In this section, the corporate governance problem is treated at a most fundamental level analysis, as forming an integral component of a broader conceptual framework in which virtue is understood to play a critical role. Before the underlying complexities motivating the extant regulatory crisis can be grasped in their fullest form—as constitutes a basic perquisite for the development of any effective set of solutions—they must first be placed in their proper context. Thus, as a wholly natural outcome, the quest for intelligibility—vis-à-vis corporate governance regulation in the modern era—requires a dominant focus upon society at large, to which the underlying problem may be traced.

The Problem

When a child is accidentally burned by scalding water, it would be illogical to place the blame upon either the bath, for being too hot, or upon the burn, for hurting. Nevertheless, that is invariably the general response when ethical failures occur in a public corporation, based upon a presumption that the corporate environment is distinct from society. Thus—to further the analogy—when the water in the bath reaches boiling temperatures, the environment within the public corporation is (somehow) expected to remain lukewarm, as if it were insulated from the vagaries of human behavior or even modern trends.

A further contradiction is the overriding tendency to blame corporations for any observed declined in societal mores.[42] As a mere matter of logic, the public corporation is either a constituent of society—for example, in which case it may be understood to both reflect as well as to share in the weaknesses present in modern culture—or it is not—for example, in which case it may reasonably be held to a higher standard. When conceptualized as being separate from society, any arguments that might seek to attribute the origin of society's problems to the modern corporation are naturally precluded. This treatise is premised upon the firm understanding that corporations—both in conceptual as well as in practical terms—are a constituent element of the societal milieu.

This is to suggest that any effort to treat the public corporation in isolation—as distinct from any consideration as to the state of modern culture—is no less realistic than an effort to divide the water from a single bath into segments, while maintaining different temperatures in each. As a result, the focus of this initial chapter, which seeks to explain the basic need for corporate governance regulation, is fairly comprehensive, extending beyond the confines of the corporate environment. The objective is to assess the corporate governance problem in light of the broader trends in societal culture, rather than as an isolated phenomenon.

However, the dominant focus of this treatise—one that seeks to be decidedly nonpolemical—is corporate governance regulation, not culture per se. Thus, the treatment of modern culture, as a constituent element of this introductory chapter, is intended not as a didacticism. Rather, the objective is to highlight salient and relevant themes, to serve as constituent elements of a basic analytic framework, as needed to engender a conceptual level understanding of the regulatory problem.

In light of the broad disagreement present within society, it is expected that the analysis of culture—as an inherently divisive issue—will prove less persuasive to some readers than to others. However, in order for the overall argument to succeed, consensus in this regard is not required: An agreement as to the fundamental origins of the corporate governance problem is of significantly less importance than a basic willingness to acknowledge the existence of fundamental deficiencies which mandate an immediate and effective solution. Thus, the assessment of modern culture is intentionally broad and general, as relevant to the focus of the discussion.

As a means of introduction, consider that, in one form or another, the love of money has—throughout the brief history of this nation—contributed to the American ethos. Thus, as early as 1835, scholars have noted: "The American lauds as a noble and praiseworthy ambition what our own forefathers in the Middle Ages stigmatized as servile cupidity."[43] Such a distinct ordering of values, relative to antecedent culture, likely supplied the basic motivation for American ingenuity, which gave birth to the very developments that are now defining characteristics of modern capitalism: for example, the public corporation, the stock market.

However, it may be argued that such an enterprise, traditionally speaking, did not prevent the development of moral sensibilities, as is generally evinced, for instance, by U.S. participation in World War I and World War II, at a tremendous loss of life and resources. This is to suggest that virtue and avarice likely coexisted, however tenuously, in early American life. In sharp contrast, a defining characteristic of contemporary society seems to be the degree to which the nature of this precarious arrangement has changed dramatically, and for the worse, such that avarice now seems to be winning out all but completely. Due to a pervasive, deeply rooted tendency within modern society to blithely conflate avarice with ethics—to the extent that any distinction has been effectively lost—the ability to realistically disentangle the two constructs, within the modern context, has significantly declined.

As an inadvertent result, a traditional, normative understanding of virtue has been all but lost to contemporary society.[44] This is not to imply that people are no longer virtuous, per se. (Whereas the expectation of a significant decline in the average level of virtue present within society would be generally consistent with this logic, the primary focus of this discussion is on ethics as it relates to the public corporation). Rather, it is to suggest that because modern culture has all but surrendered its "moral compass"—for example, as present in language and a common understanding—the capacity to pursue virtue, in any meaningful sense of the word, has been inadvertently lost.

As it relates to a discussion on U.S. corporate governance regulation, this is inherently problematic because law, whose scope and influence is naturally limited, "cannot be the answer in all or even most areas."[45] Thus a society whose main recourse is the law—for example, that is unable to rely upon the inherent capacity of its citizens to respect fundamental boundaries, independent of force—is likely to encounter surmounting difficulties. Increasingly greater force will be required to subdue the will of the governed, who will naturally respond so as to always be one step ahead of the authorities, thus necessitating consecutively greater levels of deviance over time. The likely result is a chaotic, fragmented society with an authoritarian, centralized bureaucracy.

Unfortunately, confusion within general society, as it relates to fundamental, moral issues, appears to be climaxing: "Secondhand smoke is carcinogenic; celebration of torn vaginas is 'mere words.'"[46] Owing to the pervasive influence of radical individualism, the individual has replaced society as the normative locus for concrete, moral judgments.[47] As a result, the content of individual morality—which is now defined as reflecting individual opinion rather than, as according to a normative understanding, transcendent, eternal principles—is no longer authoritative. Moral beliefs, so understood, lack the capacity to discipline the will, and therefore are unable either to positively influence—that is, to bring out the best in—human behavior, or to restrain its more egregious excesses.

The more obvious result has been a significant digression as it relates to the content of modern sensibilities—for example, society's shared sense of normalcy, as a function of its particular ordering of values.[48] Naturally, the impact of this trend has not been confined exclusively to corporate America, but has influenced every aspect of modern culture. As Aristotle noted: "Words are what set human beings, the language-using animals, above lower animals."[49] Thus, as a general illustration of the dramatic change in modern sensibilities, consider the stark, if not graphic, evolution of popular music lyrics in the past 50 years.

In 1959, (then) controversial crooner Buddy Holly released "True Love Ways,"[50] which offered nothing less than an idealistic view of romantic love as enduring, tender, and compassionate. Just 43 years later, rap artist Khia catapulted to global fame with her rhythmic hit entitled "My Neck, My Back (Lick It)."[51] Starkly absent in the latter, vulgarized portrayal of Eros is even the slightest pretention of concern for the comprehensive interpersonal needs of the human person engaged in intimacy. Furthermore, the understanding of intimacy has been so distilled over the past few decades that apparently scant remains but a heightened, crass, and banalized carnality—one that leaves little room for awe or wonder.

As this writing constitutes a treatise on regulation, not a polemic, the focus is not to decry the loss of a "traditional" sense of morality within modern society, or even to advocate renewed efforts at censorship. Rather, the purpose is to illustrate the degree to which sensibilities have changed—often in dramatic and unforeseen ways—within a relatively brief span of time, such that behavior that would have been soundly condemned just a few decades ago is now routinely celebrated.

This has resulted in multifarious concerns over what has been termed *America's culture wars*: "[p]opular entertainment sells sex, pornography, violence, vulgarity, attacks on traditional forms of authority, and outright perversion more copiously and more insistently than ever before in our history."[52] Consider what today passes for art:[53] *Shit Faith*, a painting in which "crudely drawn excrement emerges from four abutting anuses,"[54] Maplethorp's self-portrait of a bullwhip entering his rectum; lurid depictions of bestiality, amputees, and decapitated corpses; photographs of two men with young boys in very provocative poses; and a porcelain representation of an artist having anal sex with his porn-star wife.

The purpose of this discussion is to suggest that it is futile to approach the modern problem posed by virtue—or its absence—if its focus is anything less than comprehensive: "When a fire breaks out in a forest, one cannot regard it as a thousand autonomous and parallel fires of a thousand trees in close proximity."[55] In general, three principal factors effectively argue against treating the corporation in isolation: (1) corporate governance regulatory efforts, to have any realistic chance of succeeding, must be rooted in a fundamental understanding of the obstacles, inherent in society, that effectively work against the development of virtues; (2) because moral virtue as present in the corporation—as an effective antidote to the need for costly regulatory efforts—cannot realistically be distinguished from how ethics are conceptualized within contemporary society; and (3) as it may be reasonably assumed that the modern practice of conflating avarice and ethics likely took root within the public corporation, where it has been liberally employed as a means of bolstering the effectiveness of advertising appeals (e.g., consistent with the notion that strong ethics is good business).

However, over time, the practice gradually spread, first to other dominant institutions—through a process of adoption—and then throughout popular culture. The critical distinction, as relevant to this discussion, is that initial decisions to camouflage a basic corporate profit strategy as motivated by ethical concerns were entirely purposive—for example, intended to make the corporation appear more socially legitimate, so as to increase firm profits. Over time, as the practice has gradually trickled down throughout society to the most fundamental levels, the distinction—as between an initiative motivated by genuine ethical concerns and a basic quest for profits—has been irrevocably lost, to the extent that it is no longer a constituent of the modern dialectic.

As a result, ethics and avarice are now routinely conflated, to the extent that a conceptual inability to reliably distinguish between the two may be considered a defining characteristic of the modern era. The frequency with which certain business practices—ones that, properly speaking, lack any ethical dimension—are ascribed ethical qualities, strongly suggests that a fundamental awareness present within general society regarding the inherent differences between virtue and nonvirtue has been lost.[56]

A loss of understanding, however, does not equate with the general disuse of the words "virtue" and "ethics"—to the contrary, modern society professes a renewed interest in the virtue ethic. Thus what has transpired is that the virtue ethic has been fundamentally reinterpreted, largely from an emotive perspective, such that a modern reference to ethics may now connote a particular feeling (e.g., "warm and fuzzy"), as opposed to the set of true principles that govern human relationships, as may only be acquired through a difficult process of intellectual discernment.

This reinterpretation may be seen as an extension of the defining imperative of the Enlightenment—"Dare to know! Have the courage to use your own understanding!"[57]—to the moral realm. Whereas the virtue ethic is bereft of meaning apart from the community setting, the atomization of American society has reduced moral questions of right versus wrong to a series of individual deliberations, as based upon individual preferences and feelings, which are by definition transient.[58]

The now ubiquitous strategy of seeking to justify an ever-increasing range of corporate behaviors—ones that are properly rooted in the profit motive—as based upon purported ethical considerations has, as this analysis seeks to argue, exerted a destructive influence upon society.[59] However, this represents but one of many contributing factors. The institutional decoupling of "claims to virtue" from virtue, in a normative sense, has bred a particularly virulent form of cynicism, such that a practice of the virtues in the modern era seems fundamentally impossible.

As an illustration, consider the likelihood that an individual claim to virtue, assuming it were taken seriously, would, within the modern setting, be immediately rejected as based upon the general assumption—one held as axiomatic within the modern era—that all truths are relative. In other words, because the claim to virtue reflects an individual belief, and because, as a defining characteristic of modernity, all individual conceptions of moral principles are considered relative, it necessarily follows that any belief system that claims to be rooted in a set of universal, moral principles is false.[60] Thus, the individual claim to virtue will almost assured be blithely rejected, on the basis of a fundamental assumption that, because it is considered axiomatic, it requires no proof.

In other words, the moral content as contained in modern sensibilities—for example, a deeply rooted understanding common to a particular culture—has effectively ruled out the possibility for virtue. The implications of this development are not limited to abstract theory. Because the modern conception of virtue, as rooted in ephemeral emotion, is purely symbolic, it cannot possibly provide adequate motivation, as needed to justify the enormous personal sacrifices that are natural constituents of a virtuous life.[61] Bereft of any normative meaning, a mere reference to certain phraseologies lacks any ability to lead troops out of foxholes in the face of enemy fire, not to mention to compel an individual commitment to greatness.

Due to a traditional concern for the welfare of society and its longevity, societies throughout history have always held that virtue, strictly speaking, is exclusively a community affair.[62] Thus, the rapid change—one that likely seemed inconceivable in the 1950s, for instance—was made possible by one critical development: Moral deliberations, largely as a result of the impact of the 1960s, were redefined so as to represent the domain of the individual rather than that of the community.[63]

The communitarian notion of virtue was predicated upon a particular ordering of values in which the moral values—and thus the moral behavior of a nation—were understood as exerting a greater impact upon societal welfare than material concerns (e.g., GDP, standard of living, etc.). As soon as ethical deliberations were redefined to represent the exclusive domain of the individual, the preferred status they traditionally enjoyed as authoritative decrees capable of binding human behavior was reduced to the level of nonbinding, individual opinions, which are all too easily subjected to the vagaries of the human appetites.

Thus, it was simply a matter of time before every form of "ethical" reasoning would be further distilled—as a salient, defining characteristic of the modern era—so as to reflect individual taste preferences (i.e., avarice, in one form or another). As a direct result, a unique, defining characteristic of the modern era is the degree to which individual license has been championed[64]—for example, what, in traditional terms, would have been referred to politely as socially deviant forms of behavior—as a modern badge of honor: "It is hard to avoid the conclusion that a large part of the American people have turned their backs on that old-fashioned quality: Virtue—private and public virtue."[65]

As an illustration, consider Las Vegas where "the flesh market to sexually exploit young, innocent children is a 'grand affair'—one operating under near complete legal immunity. The supply of beautiful youth to enslave is equivalent to the tens of thousands of children who are unwanted, severely abused, and/or simply thrown-away as an inconvenience—kids who have been rejected by everyone."[66] That this behavior is consonant with modern sensibilities is indicated by the fact that there has not been a concerted political or social effort to put an end to it.

This does not imply that every member of the modern culture approves of such exploitation—the majority probably does not. It simply reflects that opposition within society is not sufficient to demand that the practice, and others like it, stop: "What happens in Vegas (or Alabama...), stays in Vegas." As a defining characteristic of the modern culture, the notion that individuals possess a prerogative for self-gratification that is virtually unlimited is held as axiomatic. Thus, individuals within modern society—who might otherwise get involved—are increasingly hesitant to ascribe moral judgments regarding how others seek to define what constitutes "entertainment" for themselves.

The bestiality that is widely available in lurid detail on the privacy of the Internet—for example, sadomasochism involving children, rape, and incest[67]—only further reflects as well as contributes to this trend, such that any capacity, as formerly possessed by the moral virtues, to subdue the will has been rendered more or less impotent. Because freedom, as it relates to the modern sensibilities, has been reconceptualized as representing the capitulation of the will in the blind pursuit of uninhibited passion, an individual practice of the virtues now seems decidedly unnatural, as synonymous with the state of being inhibited.[68]

Properly understood, the "many crises shaking the world today—those of the State, family, economy, culture, and so on—are but multiple aspects of a single fundamental crisis. . . . "[69] As an entirely natural result, virtue today has become the exception rather than the rule. However, a fundamental requirement for the achievement of ethical, law-abiding corporations is virtuous corporate executives. Thus, an inherent conflict exists between the present state of virtue within society and the fundamental need for ethical corporations, in order to ensure societal order and stability.

Because the problem of virtue, it may be reasonably argued, has exerted a more or less equivalent impact upon all U.S. institutions, a narrow, exclusive focus upon the public corporation may be misguided, and thus likely to fail: "Only a public morality, in which trust, truth-telling, and self-control are prominent features can long sustain a decent social order and hence a stable and just democratic order."[70] As an illustration, consider Miramonte Elementary School, which was recently closed due to extensive reports of child sexual abuse, perpetrated by both male and female staff members.[71] One teacher encouraged students to eat cookies that had been laced with semen, as part of a "tasting game."[72]

As a second illustration, consider—apart from any parochial disputations as to the specific content of faith—a longstanding institution that, for over two millennia, has sought to maintain a singular commitment to a particular interpretation of the virtue ethic: the Catholic Church. Despite the fact that the priestly vocation—which requires of the individual a unique degree of selflessness and charity—is ultimately oriented toward service, and thus is deeply intertwined with a concern for the common good, the priest-abuse scandal has not failed to rock the foundations of the U.S. Catholic Church.

As motivated by a complete lack of virtue, the priest-abuse scandal has evinced unconstrained avarice, demonstrating the degree to which individual moral license has successfully permeated society—including those institutions whose basic function is to serve as a lighthouse in the storm. Consider that the basic need for law is predicated upon an understanding that human beings—to degrees that vary—are fundamentally unreliable in the face of temptations. Although moral fragilities are universal, they exert an influence upon the individual that is nonconstant. In other words, due to the uneven distribution of human weaknesses throughout the population—as is evidenced by the wide disparity in the types of crime that are committed—avarice realistically only possesses meaning at the level of the individual.

However, a reasonable argument may be made that the nature of the malfeasant behaviors, as exhibited in the priest-abuse scandal, fail to belie moral fragility, per se, but rather indicate an individual will that has been deeply hardened to the demands of virtue, such that rather than seek, it firmly opposes the good of the other. This suggests that the ongoing moral formation provided to such individuals was not merely deficient, but careless to a wanton degree.[73] (That in select, limited circumstances, some leaders may have acted so as to condone or even encourage such behavior, however unthinkable it may seem, is not entirely without support[74]). Thus, it may be argued that the scandal itself is merely symptomatic of a much deeper problem: a dramatic and widespread loss of moral virtue among the hierarchy within the U.S. Catholic Church.[75]

Driven by avarice, the hierarchy of the U.S. Catholic Church seeks to displace Rome as the locus of modern Catholicism, as part of an effort to accumulate ever-increasing amounts of money, power, and status.[76] Thus, the priest-abuse scandal, which is an inevitable result of the loss of virtue, has been interpreted superficially as a public relations problem—so that those in charge might retain power and fulfill their plans—rather than as evincing the need for moral reformation:[77] "The U.S. Catholic Bishops have failed to meet the growing public demand for greater transparency, but instead have enacted a series of measures designed to prevent further instances of abuse in every arena except those where it actually occurred."[78]

Arguably, at a time when U.S. society needs positive role models more than at any time in its brief history, the ability of the Catholic Church in America to positively influence society is severely in question. Consider that "Enron's leaders were forced to accept culpability as well as punishment under the law for their leadership failures. This is a prerequisite if the Catholic Church in America is to retain any shred of credibility as a moral force for good in the world."[79]

As closely analogous to corporate America, the Catholic Church in America, properly understood, is not the cause of the rapid decline in virtue in modern society, though the contribution made by the priest-abuse scandal—in terms of introducing a widespread cynicism that questions even the possibility of moral virtue—can hardly be overlooked as inconsequential. To the contrary, such scandals exist, and will continue to flourish, as the natural result—one entirely consonant with the modern sensibilities—of a context in which virtue is routinely presented as decidedly out of fashion (or even worse, unhealthy), while avarice (e.g., the unconstrained, individual pursuit of passion) is presented in the most laudable terms as representing a longing for unfulfilled meaning.

To be clear, such trends are understood to be rooted in the modern sensibilities, so as to flow naturally from a deeply rooted, shared understanding that enables individuals within the modern culture to make inferences of meaning. Furthermore, because the specific content of the modern sensibility appears completely natural to the individual, and thus by definition is readily overlooked, the specific processes involved may be understood to operate below the level of consciousness.[80] Consider that those who lived during the Victorian (or Elizabethan) period were fundamentally unaware that their specific mannerisms, modes of thought, and conceptualizations of reality were so distinct from other cultures that they might later be characterized as "Victorian." To those who lived during this era, the Victorian sensibilities would have seemed natural, and thus completely inconspicuous.

The same is true now: Because the unique, defining characteristics of this era seem perfectly natural to us, they go completely unnoticed. As a result, it is virtually impossible, without significant reflection and/or study, to detect the influence of the modern sensibilities on individual behavior.[81] Consequently, this analysis, by definition, eschews any theory that presupposes a conspiratorial influence in the promulgation of "countercultural" values[82]—for example, so as to reap higher revenues from movie sales. Rather, this analysis presumes that observed outcomes are the result of completely natural processes, as reflecting what modern culture takes for granted as a completely normal mode of thought or behavior.

Whereas efforts to alter the content of the modern sensibilities in a desired direction is likely to prove difficult, so long as organizations continue to derive superior (financial) rewards from strategies marketed as "ethical," the modern preoccupation with "corporate ethics"[83] will continue. Thus, a truly ironic, but defining attribute of the modern era is the vigorous display of interest in ethics, and a simultaneous, significant decline in the practice of virtue.[84] Thus, consider—as an admittedly cynical analogy—a society that so loves eating that a dominant pastime is spent viewing pictures of juicy steaks, succulent lobster tails, and lavish desserts (apple pie, rich and creamy chocolate mouse). However, during meals, rather than feast upon such culinary delights, its citizenry eagerly consumes sugar-coated plastic and cardboard, based upon an assumption—held as axiomatic—that a universally compelling concept of nutrition is impossible.

Business Ethics

A parsimonious understanding of applied virtue requires noting the fundamental distinction that exists between truly ethical initiatives and the various movements in modern, corporate life that are marketed under that same title but that naturally fail to qualify. To be clear, it is widely understood that corporate ethics—that is, claiming to abide by the highest ethical standards—is good business.[85] However, an ostensible "commitment" to ethics as based upon some understanding that "ethics is good business"—and thus profitable—is not ethical, per se, nor is it likely to provide an adequate motivation for ethical behavior.[86]

That is, as soon as it becomes painfully apparent that ethics is not always profitable, good intentions will quickly revert to self-interest, and avarice will once again dominate. For example, Enron's corporate ethics statement, which was so highly regarded that it was published as a book and distributed to employees, was considered exemplary in its time.[87] However, Enron's dramatic fall from grace readily attests to a disparity, whether immediately apparent or not, between marketing claims and organizational focus.

To be truly virtuous, a specific course of action (behavior) must be valued on its own merits, and not according to its potential to produce an external reward. This is to suggest, at a very broad level of analysis, that the vast majority of popular, corporate initiatives prevalent today—for example, from corporate ethics statements to Corporate Social Responsibility (CSR) programs[88]—are not necessarily ethical. Rather, as a fundamental component of firm strategy, their purpose is largely utilitarian: the achievement of specific, preordained objectives (e.g., enhanced perceptions of social legitimacy, increased profitability). (It may further be argued that the organizers of such initiatives are not fundamentally driven by overriding ethical concerns—for example, the development of "corporate virtue"—but rather by a desire to use a "virtue approach" as a means of achieving specific, preordained ends. However, that is a topic beyond the scope of this book).

Because the focus of this discussion is fairly abstract—for example, so as to touch upon what does or does not constitute an ethical action—its practical implications may not seem immediately apparent. As an illustration, consider a given firm that is compelled by social pressures to adopt an ostensibly desirable social cause—one possessing broad appeal within the communities in which it operates—but which is nevertheless fundamentally unrelated to its business operations. Because the firm is understood to have embraced a socially desirable cause, any discussion as to the ethical nature of the actual cause is likely to seem superfluous. However, that is to miss the fundamental point: The particular firm, in this example, is not driven by a desire to do good, but by an inordinate desire for increased profits.

As a direct result, the same firm may just as easily support an effort to defend a certain "animal species" today—on the basis that it is profitable to do so—as it might lend support to fundamental human rights violations in the future, as incentives change. This is not merely true in the abstract. Consider that the list of companies that directly supported Hitler and his death camps during World War II was by no means small. As only one of many potential examples, the global firm Allianz insured Auschwitz, while one of its former chief executives served in Hitler's cabinet.[89] Thus, various initiatives that seek to compel firms, through principally nondemocratic means,[90] to comport with preordained ends may be well-meaning, but they miss the point. The future well-being of society requires that corporate executives, like other citizens, be virtuous. Thus, as a minimal condition, it is necessary that they learn to form decisions in accordance with fundamental moral principles—independent of the degree to which they may comport with the modern zeitgeist—rather than in response to relatively effective means of social coercion.

To be clear, this is not to suggest that the normative role of the modern corporation is to engage in selfless acts of altruism. Thus Francis Bernardone (ca. 1226),[91] who gave all of his father's goods to the poor, fails to constitute a normative model for the corporate executive, despite his exalted status as St. Francis within the Catholic Church. Rather, the purpose of this discussion is to illustrate the degree to which a modern discussion of ethics has become complicated.[92] Consider that firms, in general, have a direct responsibility to their shareholders to enact strategies (e.g., marketing, operations, product mix) that maximize the value of the firm—a particular topic that, having already been discussed ad nauseam,[93] receives only superficial treatment in this text.

However, it is important to note that this responsibility is naturally limited: Firms are constrained by laws, and—as this discussion seeks to argue—moral principles, which managers must follow if the interests of society is to be well served. It is widely understood that corporate violations of the rule of law detract from the welfare of society.[94] However, the vast potential for profound, negative externalities to result from of violations of an explicitly moral rather than legal nature is generally overlooked, much to the detriment of society—as the following discussion seeks to argue.

A brief focus on the ominous implications of this latter trend, as discussed forthwith, is entirely relevant to a treatise on regulation for two important reasons: (1) while clearly demonstrating the inherent limitations of the law as a means of safeguarding societal interests, (2) it belies the unequivocal need, as Aristotle might concur, for corporate managers to be animated internally by virtue rather than externally by corporate compliance initiatives. This is to suggest that the current emphasis upon regulation as the primary means of safeguarding societal interests vis-à-vis the public corporation is misguided. Furthermore, the following discussion is not intended to impugn the executive, but rather to illustrate, as entirely natural, the deleterious outcomes brought about by a widely held, shared belief that the intended ends (i.e., corporate profits) justify the various means employed (i.e., manipulative marketing).

As one illustration, consider the myriad of relatively sophisticated Pavlovian-like approaches employed by firms—both ubiquitously and with great success—to *induce* consumer spending by manipulating latent psychological processes germane to the adolescent stage of development. Adolescents are the most obvious target, as their impressionability renders them vulnerable to manipulation, and as they are of relative economic significance. Furthermore, this genre of marketing—as distinct from an appeal to reason—is inherently manipulative, and, as it will be argued, ultimately destructive.

As a general means of introduction, such corporate efforts at manipulation may be characterized in the following manner:

- *The Stimulus*: Through careful study of its target market, the firm shrouds its basic wares in a deftly scripted set of lifestyle decisions, beliefs and so forth, referred to simply as a "mystique."
  - This mystique is intended to bait a *negative* response from specific groups the intended target market defines as authority, thus motivating the process of differentiation.
  - The controversy generated provides free publicity to the firm, further intensifying the main effect.

- *The Response*: The backlash triggers the process of differentiation, causing the adolescent mind to conflate the mystique, as an artificial construct concocted by corporate executives for profit motives, with the genuine need for differentiation. As a result, the adolescent adopts—to varying degrees—the mystique, as a salient means of establishing a personal identity.
  - Through conditioning, the need for differentiation is now experienced by the adolescent as a desire to buy the firm's products.
  - The manipulative effect requires ignorance of the underlying processes at work: the process occurs on a subconscious level. Consequently, to the adolescent, the new identity represents a genuine or spontaneous outgrowth of the individual's own personality.

As an illustration, consider prior efforts by corporate record labels to market a genre of rap music—the majority of which is consumed by youth—which advocated murdering police officers. Rhetorical condemnation from authority figures within various communities was swift and unequivocal. This was followed by an equally predictable result: explosive commercial sales, especially, though not exclusively, in those specific communities where the underlying sentiments expressed—for instance, a general distrust of police officers—found clear resonance.

Also consider global retailer Abercrombie & Fitch, whose impressive, global fortune was achieved through a sexually explicit approach to the adolescent consumer market. This has included a number of catalogs featuring partially clothed minors in an array of compromising positions and complete with provocative subtitles, along with nude photographs of various women, such as porn-icon Jenna Jameson. The firm also markets thongs and padded bras to girls as young as 8. Quite predictably, Abercrombie & Fitch has been denounced by a broad coalition of family and children's rights organizations, thus providing free publicity. More relevantly, in 2012 the firm's global sales eclipsed $4 billion.

Firms employ manipulative marketing techniques because they are highly effective: The ends (i.e., profits) are understood to justify the means (i.e., consumer manipulation). As an egregious example, consider the various efforts employed by the fashion industry to profit from the unhealthy obsession certain young girls have with their body image, by intensifying their angst. Through a carefully scripted mystique, known as the "heroin chic," these girls are introduced to an alternate reality in which a fatal addiction, and its many symptoms, is presented as alluring and beautiful. This constitutes a calculated effort to induce young girls with eating disorders to conflate a moral evil (i.e., heroin addiction, which is deadly) with beauty. Thus, independent from any consideration as to the influence upon the target market, the morally depraved nature of this approach can be readily demonstrated.

However, to demonstrate an action as immoral fails to imply that there are no damaging effects associated with it. Firms are widely known to produce negative externalities—for instance, pollution—which are excluded from the cost of production. The relevance of this topic to the discussion is easily demonstrated in the following example. Consider a hypothetical firm that, as a result of its operations, creates $1 in "net-value" for society, but in the process must emit pollution that costs $2 to clean up. Regardless of who pays the clean-up costs (i.e., the firm's shareholders or, in the event that the pollution remains concealed, society) it is clear that the firm, on the net, is destroying rather than creating value. Unfortunately, the research in this area has focused near exclusively on effects that are relatively easy to prove, namely environmental effects, while ignoring the potential for firms to impose social costs upon society.

As a result, it is necessary to analyze whether "manipulative marketing" techniques have the potential to produce significant, unwanted externalities. To begin, recall that reliably inducing the desired effect (i.e., purchases of the firm's products) in an adolescent target market requires firms to purposively eclipse societal norms so as to elicit backlash from authority, as is fundamental to the achievement of a strong stimulus–response relationship. Repeating this process over time on successive generations of consumers is likely to be associated with two important outcomes: (1) a desensitized public as firms, over time, seek to violate society's established norms more and more over time in order to achieve the desired result, and (2) a youth that is increasingly self-destructive, as successive generations of adolescents are influenced by firms' efforts.

Thus, purely on the basis of logic, it can be demonstrated that manipulative marketing techniques, when employed routinely and on a widespread basis—for instance, as in the U.S.—will be associated, over time, with: (1) a gradual reduction in the ability of shared norms to positively influence behavior, and (2) a marked decline in the behavioral standards for youth, and an increase in destructive forms of behavior. For instance, consider the impressive, documented success of Abercrombie & Fitch's campaign, which offers persuasive evidence of the firm's ability to influence its target market. As the firm's carefully scripted mystique addresses a wide range of behaviors and attitudes, the likelihood that the effect is confined exclusively to consumer buying behaviors is small.

A more probable expectation is for Abercrombie & Fitch to have induced, within its target market, a significant increase in sexual activity and/or the number of partners, along with a reduction in the initial age of onset, thus exacerbating the already epidemic problem of sexually transmitted diseases among U.S. youth. Consider also that one purpose of societal mores is to shield, through a variety of means, those who are vulnerable to exploitation—for instance, by defining sexual contact with minors as a form of taboo. Thus, it was considered necessary to construct boundaries around children as a means of insulating them from potential abuse. As a result of its efforts to caricaturize minors as sexual objects, and the appearance of social legitimacy this lent to related trends in society, it is likely that the vulnerability of minors to sexual exploitation by adults was inadvertently increased by the firm.

However, to focus myopically on whether or not the billions of dollars of shareholder capital, as invested over time into such campaigns, have significantly increased destructive behaviors—for instance, heroin use, murders and so forth—is to miss the point, even though the available evidence seems to warrant such a conclusion. As an illustration, assume a firm seeks to induce demand among upper-middle class adolescent males for designer underwear. To achieve this, it crafts a particular mystique in which the act of subjugating and enslaving women and children is presented in the most alluring terms. Assume as well that the campaign proved ineffective: Not even one instance of abuse towards a woman or child was successfully induced within the target market.

What might this imply? As a basic matter of logic, it fails to infer that the firm's efforts were benign. Enslaving another human being is such a drastic measure, that inducing the desired stimulus–response relationship may prove impossible in certain target markets. However, it is probable that the firm still achieved a pronounced *attitudinal* effect within the target market, as exhibited by a general loss of respect, if not crass insensitivity, towards woman and children. The latter effect, while difficult to measure, would still result in the imposition of long-term, negative costs for society—for instance, it might decrease important quality of life measures such as marriage rates, racial harmony, and/or the success of child-rearing efforts. This is to suggest that efforts to defend manipulative marketing on the basis that not *all* children are murdering police, or taking heroin have set the standard so low that it no longer has any practical meaning.

Corporate executives at such firms as Abercrombie & Fitch, and others who employ such methods, will naturally seek to deny any association between their efforts and the slightest externality. However, this brief discussion suggests that corporate rapacity in the modern era may be characterized by two key factors: (1) the absence of any concern for the general welfare of the adolescent consumer, and thus for the long term interests of society, and (2) an unflinching willingness to purposively exploit known weakness within the target market—for instance, eating disorders—as a potent means of driving shareholder profit, irrespective of the potential consequences. Unfortunately, prior generations may very well have defined such activity as pathological.

Thus, the enormous vacuum created by the palpable absence of any authoritative role for virtue as a criterion for contemporary decision making has made it possible for a mistaken notion of the "common good" to be defined exclusively in terms of avarice. As a result, any normative understanding of community, in which individuals are understood to seek the good, not only for themselves but also for others, has been lost. A conceptual understanding of the world in which unconstrained avarice has been redefined as a virtue now dominates. As a result, the ability of laws to restrain the worst instances of corporate malfeasance, many of which receive both legal as well as social approbation, is greatly reduced.

Thus, a natural query at this point is whether the effort to regulate the public corporation in a manner consistent with society's long-term interests is remotely possible. (If the answer is "no," a book on corporate governance regulation is unlikely to prove very useful!) Thus, the focus of the discussion turns towards this pivotal issue, so as to determine whether a peaceful co-existence between the corporate structure and society is attainable.

Is the Corporation Disordered?

Consider the relevance of this question: Were the corporate structure to be intrinsically disordered, all regulatory efforts—no matter how fundamentally sound or rationally justifiable—would fail to produce the desired results. As a result, a comprehensive treatise focusing on corporate governance regulation must at least consider the possibility that regulatory failures may be induced by flaws inherently related to the corporate structure. To be clear, this discussion is intended neither as a defense, nor as an impugnment, of the corporate form of ownership, nor does it suggest a causal role for the corporate structure in the rapid, observed decline of virtue in modern society.[95]

Whereas a great deal of research has focused on the public corporation,[96] much of it decidedly negative,[97] and far less of it in defense of the corporation, the rational basis for either position appears tenuous at best. Since corporate management teams—contrary to many media reports—are comprised of human beings,[98] not carnivorous beasts, the modern corporation constitutes a microcosm of society, and thus shares in its modern sensibilities, for better or for worse. Generally speaking, corporate executives are affected by the same moral deficits, rational flaws, biases, and value distortions as present in society at large. Thus, any blithe presumption that general deficits—for example, in moral formation or in character—that are present in general society should naturally fail to make their presence known in the corporate boardroom, where the temptations to engage in self-seeking behaviors are bound to be plentiful, pernicious, and enticing, is unreasonable.

The brief discussion, thus far, might infer two natural outcomes: (1) that, generally speaking, harsh condemnation of the corporate structure is at least partially rooted in a failure to acknowledge that public corporations—as inanimate entities—reflect, rather than drive, culture; and (2) that, properly conceptualized, the modern problem of virtue[99] extends well beyond the confines of the corporation, where its role is more symptomatic than it is causal.

Thus, any remedy, possessing a realistic potential to be effective, would likely have to take root long before the future corporate executive ever begins the long ascent to the throne of corporate power. This is to suggest that it would be an exercise in pure futility to impose unduly stringent, pervasive, and sharply reactive corporate governance regulations, which focus exclusively on the corporate manager relatively late in life, when the character has already congealed. Rather, what is likely needed—at a very practical level—is a proactive effort to address the general needs for character development as present within society at large.

Thus, a training in the virtues could—and probably should—be required of all individuals before they actually become senior executives.[100] However, a more realistically efficacious, though immeasurably more costly and difficult, approach would involve a fundamental reconsideration of the current experiment—one that serves as a defining characteristic of the modern era—that insists, to a degree that is unprecedented in human history, on affording the individual near absolute moral license.[101] So long as individuals within society receive encouragement to give fundamental expression to their whims and passions, without any emphasis upon the need to also consider the welfare of others, problems that arise from unbridled self-interest will continue to exist.[102]

Considered at a very basic level, and of immediately greater relevance to the topic is that the conceivable, rational basis for denying the same fundamental "right" (e.g., of near-absolute individual license) to the corporate executive—whose tastes and preferences may be different from others within general society, but that cannot, within the modern dialectic, be adjudged as either "better" or "worse"—is decidedly unclear. This is to suggest that, as a natural outcome independent from any other considerations, the limits on managerial behavior will continually be tested, irrespective of regulatory responses, which can reasonably be expected to grow continually more reactive, heavy-handed, and costly. Far from presenting such outcomes as desirable, or even warranted, the purpose is merely to note it as one that is fundamentally consistent with the modern ethos.

To the degree that the analysis is correctly rooted in logic, an ability to produce more auspicious outcomes would require substantive alterations to modern sensibilities, as a constituent aspect of culture. Since culture can reasonably be assumed to be intractable, such changes will prove extremely difficult to achieve. This is to suggest, at a very basic level, two natural outcomes: (1) that modern corporate governance regulation, as characterized by relatively draconian and pervasive efforts to enforce some minimal level of corporate ethic, is bound to fail, in part due to a general failure to adequately conceptualize the underlying problem; and (2) that a society that deeply cares about its future would take every opportunity to instill its citizenry with virtue, beginning at a very early age, thus ensuring not only their individual happiness, but also the future integrity of the community, since the overriding concern of the virtuous, by definition, is the common good. Furthermore, this discussion suggests, as a natural outcome, that the basic corporate structure, as a critical constituent of modern capitalism, is not inherently flawed; rather, the problem is more deeply rooted and thus fundamental to society.

It is also quite possible that—as applied to at least a proportion of the most scathing attacks[103] inveighed against the modern corporate structure—as much is revealed about the individual disputant as is revealed about any potential flaws in the corporation. One conceivable argument may be that the precise motivation for harsh criticisms directed against the modern corporation[104] is rooted less in the corporate structure than in its ability, as a palpable symbol of modern capitalism, to evoke the very types of connotations that give rise to powerful sentiments.[105] This is to suggest that the corporation is frequently attacked, not so much for what it is, but rather for what it is understood to represent.

Consider that corporations have long provided a generous target for individuals (e.g., researchers, politicians) hungry for recognition,[106] thus inferring that its status as a frequent target of rhetorical condemnation[107] stems, at least in part, from factors fundamentally unrelated to rakish behaviors, contrary to what is commonly presumed.[108] For instance, one such likely factor involves the prominent status enjoyed by the public corporation within modern society—one so apparent that the salience of the business firm, as a relatively neutral frame of reference, is all but guaranteed on a near-universal scope. A second, potentially more relevant, factor stems from the fact that any efforts to effectively render the appearance of an "assault" against the individual corporation—for example, as if it were a person, apart from the strict legal sense[109]—are virtually costless, and thus require neither special competence, nor courage (e.g., due to the absence of any risk of reprisal).

The first such factor merely suggests that because corporations are widely known throughout the world, they constitute a useful starting point for discussion. The second, less intuitive but likely more relevant, factor refers to the "Don Quixote effect," which may be explained as follows. Consider, at a very basic level, several characteristics of the typical, modern corporation. Despite the possession of a wide range of assets and core competencies, as well as an extensive operating base, and a noted ability to influence—for better or worse—important social as well as political developments within society, the modern corporation—as a social institution—remains vulnerable to a wide range of imperfections. The inevitable result of these factors, taken in the cumulative, is not only that mistakes—some quite serious with deleterious, far reaching consequences—will consistently occur, but that those that do are destined to achieve a certain degree of notoriety within society. Thus, this high degree of salience may be understood to afford an easy "target" for the would-be crusader.[110]

Furthermore, due to the sheer inevitability that the crusader (even when overtly mistaken as to the facts[111]) will appear to the outside world as brave and chivalrous—owing to the size and power of the corporation relative to the individual—such crusades are effectively encouraged. Because corporate entities, like windmills, are unable to fight back—for example, its owners are broadly dispersed, among millions of individual investors throughout the world, causing any form of reprisal to be completely unlikely—such attacks are virtually costless.

As a result, a logical expectation would be for such "attacks" on the modern corporation—especially those which are particularly salacious,[112] and thus whose primary purpose is to vilify—to be relatively frequent, but not necessarily tied to specific (egregious) corporate practices.[113] Whereas this analysis fails to imply that all—or even most—criticisms of public corporations lack merit, it does suggest that attacks on the modern corporation, in and of themselves (and thus considered apart from any substantive concerns), fail to reliably indicate the moral tenor of corporate America. These factors imply that the longstanding controversy surrounding the corporate form of ownership[114] reveal significantly less about the nature of the corporation, and its propensity to commit harm, than is commonly presumed.

Thus, a fundamentally reasonable expectation may be that ethical dilemmas, properly speaking, appertain to the corporate form of ownership no more or less than to other organizational forms. An illustration of a prominent organizational form—one alternative to the corporation—that has witnessed its fair share of egregious violations in the modern era is the modern university. As an intellectual mecca, the university has traditionally enjoyed an exalted position within society, to the extent that its members have largely been considered far removed from any specter of moral incrimination.

However, in the last decade, scandals have increasingly plagued U.S. campuses, many of which have directly involved faculty and/or administration.[115] University faculty and/or staff have been convicted of a wide range of offenses, from selling cadavers originally donated for research to exchanging grades for sexual favors.[116] Because such offenses are relatively transparent, they are easily recognized for what they are: fundamental moral violations.

More consistent with the focus of this discussion—and potentially more damaging to the moral fabric of our nation—are efforts by universities to market, under the guise of ethics, strategic initiatives more properly rooted in avarice. A prominent example is the University of Notre Dame,[117] whose MBA program[118] is aggressively marketed as an advanced form of ethics training: "The focus on ethics and societal impact is foundational to the business school at Notre Dame."[119] However, the actual curriculum fails to provide students with any type of formation in virtue ethics. Instead, MBA students are conditioned to conflate personal opinion—on a wide range of business-related topics—with substantive ethical principles, such that they may be considered virtually interchangeable.[120]

This constitutes not merely a miseducation in the virtues, but an egregious abuse of the student, who is employed as a pawn—presumably inadvertently—in the pursuit of a preordained, institutional end: higher rankings and tuition revenue.[121] Not only is the university's behavior in this regards rakish,[122] but the impact upon the student is likely to be long-lasting. Consider that the potential to lead a virtuous life requires that conditioned biases be firmly supplanted by reason. Thus, as a minimal condition to progress in the virtues, it is fundamentally necessary that the individual first be able to acknowledge that ethical principles exist independent of individual beliefs.

However, such an outcome in this context is extremely unlikely for several reasons. The first is that students have been assured that they are in fact receiving an "ethics MBA,"[123] one that affords particular insights into ethical quandaries related to business. Second, as it reflects an assertion from a prestigious university, it is not likely to be questioned, especially by students who naturally lack the requisite expertise, and who furthermore are likely to be harmed by a noted decline in the perceived value of their degree. The third reason that students are likely to resist any realistic effort to overcome their learned biases is due to the inherent difficulties involved: The educational process has become twice as difficult, as requiring the student to overcome conditioned biases as a prerequisite for achieving an ethical formation. This would require an unusual degree of introspection, as needed to permit a critical examination of an individual's fundamental belief system, and thus is unlikely.

A purpose of this most recent discussion is to illustrate the degree to which the problem of virtue, extending well beyond the confines of the corporate structure, has infected society at large. This fails to imply that a (regulatory) focus on the corporation is entirely unwarranted. For instance, a logically conceivable argument may be that—due to the unique attributes of the corporation in terms of size, resources, and so forth—an equivalent (moral) deficit, when present within the corporation, can be expected to exert a more onerous influence upon society.

However likely this may be, it fails to address what is perhaps the immediately more salient question: Is it realistically possible to remedy the problem of virtue, as present within society, through an exclusive—or even dominant—focus on the corporation? The answer to that question is almost assuredly "no." Such a narrow, and thus ill-fated approach—when analyzed as a fundamental matter of logic, and thus without reference to a specialized science (e.g., sociology, criminology[124])—may be reasonably expected to alleviate only a minute proportion of the various symptoms, while completely failing to halt the progression of the disease.

THE POLICY FRAMEWORK

Crafting effective regulation requires an understanding as to its basic purpose. Furthermore, without this conceptual mapping, the evaluation of regulatory policy—and its ability to fulfill its objectives—becomes impossible. As a result, the following discussion seeks to define, at a fundamental level, why corporate governance regulation is necessary. Benefitting from these insights, the discussion then seeks to introduce a basic, conceptual framework upon which effective regulation might be constructed.

The Regulatory Telos

Crafting efficacious policy requires a clear understanding as to why corporate governance regulation is fundamentally necessary. Absent a conceptual-level understanding, the fundamental need to anchor U.S. corporate governance policy in a secure, rational foundation is likely to become obscured, thus encouraging not only inefficacious policy, and therefore waste, but also policy drift—for example, where the telos of policy deviates from its natural course. (The most extreme example of policy shift may be referred to as the "Don Quixote effect," named after the hero of Cervantes' *Don Quixote de la Mancha*, who focused his energies on conquering windmills.)

Two perspectives are employed to illustrate the natural telos of modern corporate governance policy. The first envisages corporate governance regulation as a response to the various problems that arise due to agency: Shareholders, as owners of the firm, hire managers with specialized capabilities to manage its operations.[125] Monitoring problems arise between the firm's owners and its managers due to factors such as a lack of physical proximity, of specialized knowledge, and of information. Thus, the firm's owners contract not only with management, but also with professional monitors[126]—for example, a board of directors, attorneys, and accountants—to ensure that their interests are faithfully represented. As understood from this basic perspective, U.S. corporate governance policy—both before and after Sarbanes-Oxley—seeks to augment this "nexus of contracts" so as to mitigate the various conflicts that are likely to arise over agency.[127]

However, such an interpretation has come under criticism as aesthetically displeasing, simplistic, and/or mechanical. A potentially more intuitive framework for interpreting the complex social order upon which the public corporation rests involves the principle of reciprocity.[128] A key advantage over competing frameworks the principle of reciprocity affords an effective illustration as to the enmeshed nature of the complex structure of relationships that make up the corporate structure. Thus, it is possible to conceptualize the firm as a "nexus of relationships," rather than simply as a "nexus of contracts."

Of particular relevance, the principle of reciprocity infers that the enmeshed relationships that comprise the firm must function properly—according to a specific, preordained manner—if the corporate structure is to remain intact. For instance, consider the basic principle that shareholders' needs will be met only insofar as managers, boards, and others agree that shareholders' interests merit attention.[129] However, this outcome depends on the degree to which shareholders agree to serve the interests of these other groups—for example, by supplying the agreed-upon financial capital, compensation, and so forth. Problems are bound to arise because the reciprocal nature of the arrangement is imperfect: Invariably, the particular needs of some groups will not be met, while others will receive less than they bargained for.

Thus conceptualized, corporate governance regulation represents a formal response to the various problems that arise when those with less power invariably receive less consideration.[130] Governance regulation seeks to restore and/or preserve the reciprocal nature of the enmeshed relationships that constitute the firm, thus reinforcing the basic principle of reciprocity.

Why Consider Virtue?

Policy architecture reflects the dominant beliefs and assumptions of policymakers. An improved conceptual foundation—as a prerequisite for future improvements in regulatory effectiveness—may be achieved only by first developing a fundamental understanding of modern policy architecture. Consider that a distinct feature of corporate governance regulation in the modern era is an assumption as to heightened rationality. Within this general framework, decision making represents the rational outcome of a (more or less) continuous series of cost-benefit analyses. Corporate managers—very much like the firms that employ them—are interpreted as engaging in a process of profit maximization, where decisions reflect the output of a utilitarian calculus. Hence, a basic—and relatively noncontroversial—implication of this framework is that managerial fraud is likely to become more pervasive as the potential rewards begin to outweigh the perceived costs, as follows:

$$\begin{aligned}\text{Potential Rewards of Fraud} &= \{(\text{Probability success}) \\ &\quad \times (\text{Expected personal gain})\} \\ \text{Costs of Fraud} &= \{(\text{P.detection}) \times (\text{P.conviction}) \\ &\quad \times (\text{Expected penalty}) + (\text{Social stigma}) \\ &\quad \times (\text{P.innocent}) \ldots.\}\end{aligned}$$

Thus, managers are understood to continuously weigh the associated costs and benefits, as they relate to the decision to commit fraud (or other acts of corporate malfeasance). As a basic reflection of this assumption, regulation in the era of Sarbanes-Oxley has sought to increase the penalties attached to corporate malfeasance, while also significantly increasing the range of punishable offenses:[131] "Fear is strengthened by a dread of punishment that is always effective."[132]

The elaborate system of incentives belies a fundamental reliance upon a universal imposition of harsh penalties so as to curtail corporate malfeasance.[133] Because the conceptualization of the policy problem is too narrow, the model lacks explanatory power, producing tremendous inefficiencies, and thus excessive costs. Absent from this calculus is any acknowledgment as to a normative role for managerial virtue in corporate decision making. Thus, a rake and an avowed ascetic are understood as sharing an equivalent propensity to commit fraud: an aberration that reveals either a complete failure of logic or a belief that words lack any normative meaning.

A particular conceptualization of human behavior, according to Aristotle,[134] is arguably more profound, thus reducing any "unexplained variance" present. A particular focus of this section is to accurately interpret Aristotle as a means of illuminating the particular issue of regulatory efficacy—a difficult task. To be clear, Aristotle—who lived more than 2,000 years ago—wrote nothing on the subject of U.S. corporate governance regulation. Thus, any apparent attributions to Aristotle that implies a direct reference to the contemporary setting are either wholly inadvertent, or intended as a linguistic convention—for example, so as to promote efficiency in writing. Consider that within an Aristotelean framework, corporate malfeasance may be considered symptomatic of a more fundamental crisis: an alarming dearth of virtue—*ethikē aretē* in Greek—within society, and thus one not exclusive to the executive class.[135]

Since a large proportion of this chapter is devoted to the topic of virtue—an admittedly difficult construct to grasp in light of the modern confusion over the term—Shakespeare's history play *Henry V* seems to offer a relatively helpful starting point for the discussion:

> A speaker is but a prater, a rhyme is but a ballad.
> A good leg will fall, a straight back will stoop,
> a black beard will turn white, a curled pate will grow bald,
> a fair face will wither, a full eye will wax hollow;
> but a good heart, Kate, is the sun and the moon—or rather the sun and not the moon, for it shines bright and never changes.[136]

Thus, in the most basic sense, the virtuous person is not only good-hearted, but reliable, and therefore can be trusted to consistently choose the good, even when all else in life might fail. Furthermore, when properly understood, virtue[137]—by definition—precludes any form of decision-making as based upon a calculus of the underlying costs and benefits,[138] since its natural telos is rooted in values, rather than avarice. Thus the virtuous executive—who over time and through the "experience of the actions in life"[139] develops "fine habits"[140]—eschews malfeasant behaviors, irrespective of their potential to provide short-term personal gain—for example, wealth and recognition.

The net effect is to mitigate, rather than exacerbate, potential problems related to agency. Possessing high regard for the integrity of the corporate structure, the virtuous executive acts responsibly, so as to reinforce the basic principle of reciprocity.[141] Consider that radical individualism, as a defining characteristic of the modern era, recognizes no external constraints upon an individual's right to self-expression, and therefore can only lead to moral chaos and, ultimately, the disintegration of society. Conversely, virtue acts to safeguard, preserve, and thus congeal the most laudable aspects of culture: "The only liberty I mean is a liberty connected with order; that not only exists along with order and virtue, but which cannot exist at all without them."[142]

Conversely, when authority within the corporation is entrusted to the nonvirtuous, definite and serious problems result.[143] The absence of virtue—a particular condition in which the will refuses to submit to the force of reason[144]—causes the individual to become disordered. As a result, the nonvirtuous manager lacks any real concern for the good of others, and thus actively seeks opportunities to circumvent the basic principle of reciprocity,[145] which holds the fragile corporate structure together like a weak form of glue. The structure of enmeshed relationships, upon which the proper functioning of the public corporation naturally relies, begins to unravel. Invariably, those who lack adequate recourse are cheated. When accumulated over time, the increase in nonvirtue produces the defining characteristics of a corporate scandal, resulting in increased public demand for effective corporate governance regulation.

A particularly noteworthy feature of modern corporate governance regulation is its failure to acknowledge, even as a remote possibility, that disparities in terms of virtue constitute an important source of CEO heterogeneity. One contributing factor is the rise of moral relativism—"one man's vulgarity is another man's lyric"[146]—in the modern era, which makes it virtually impossible, in practical terms, to effectively differentiate the virtuous from the nonvirtuous. Adding to the confusion, society's dominant institutions, political leaders, and even religious organizations are entirely unable to "agree upon a systematic moral philosophy."[147] Because moral deliberations about what is right versus wrong are automatically reduced to the level of individual opinion, and thus robbed of any authoritative influence, they cannot possibly serve as an effective safeguard against the vagaries of human behavior.

As a result, modern corporate governance regulation is unable either to reliably stimulate virtue or even to acknowledge it, when it is fully present. Thus, its "depth perception" is relegated to one or two—rather than three—dimensions. Despite a pronounced propensity to bemoan,[148] in no little detail, the pitiable state that often results from rakish corporate behavior,[149] the modern governance framework is blind to its causality. The result, like the plot of a daytime novella, has been an intermittent series of crises with no solution in between.[150]

Thus, the very tangible and weighty implications of a flawed governance model are not confined to abstract theorizing. Efficacious remedies have eluded the modern policymaker,[151] whose only remaining option has been to become increasingly formulaic, prescriptive, and thus narrow in focus: efforts that, on the whole, reveal a blatant sense of futility, rather than any semblance of optimism for the future.[152] Consonant with this focus is a virtual genealogy of regulatory formulas, each successive update required to replace the prior failure;[153] thus Sarbanes-Oxley begot Dodd-Frank,[154] which in turn will beget another costly successor of equally dubious potential efficacy.[155] Thus resides the origin of "a new system of regulation that throttles innovation through the ever-increasing complexity of its rules."[156]

Consider that a statistically nonrepresentative series of accounting improprieties spurred legislators into a desperate frenzy,[157] thus resulting in the imposition of a fundamentally flawed[158] governance model—Sarbanes-Oxley—upon the entire universe of U.S. public firms.[159] The result was a near-unprecedented waste of private and public resources,[160] which were legally confiscated and then dumped into a cauldron of inefficacious mechanisms possessing little or no apparent rational justification.[161] A "review of the empirical literature suggests that a case does not exist for the principal corporate governance mandates"[162] in Sarbanes-Oxley. Oft is it noted that "youth is wasted on the young,"[163] while far less frequently has it been noted that modern corporate governance regulation is wasted upon the governed: both the virtuous and the nonvirtuous.[164]

Consider that in the former case, a given proportion of managers—likely much higher than popular wisdom might suggest[165]—would never willingly commit fraud, even when the probability of detection reduced to zero.[166] Thus, the costly regulatory efforts are of no direct relevance to them.[167] In the latter case, when seeking to address the rakish executive, modern corporate governance regulation has proved entirely inefficacious, because it is no less wasteful. Consider that the number of corporate fraud cases under investigation has increased by more than 80 percent since 2003,[168] and that Sarbanes-Oxley has exerted absolutely no influence upon the incidence of corporate fraud.[169] In 2007 alone, over 490 corporate and securities fraud convictions were obtained, whereas 33 insider trading indictments were returned against executives at such respected firms as Goldman Sachs, Morgan Stanley, Credit Suisse, and UBS Securities.[170]

The refusal to acknowledge a normative role for virtue—as a defining characteristic of the modern era[171]—has cost both the U.S. economy and the taxpayer tremendously,[172] encouraging wasted (direct) spending on failed policies and a plethora of deleterious, unintended effects.[173] Consider that no matter how copious the rules proscribing corporate malfeasance may become, nor how onerous the attached punitive measures,[174] nor how many enhancements afforded the corporate monitor, the basic potential for the nonvirtuous manager to "override" the system can never be eliminated, nor is it likely to be reducible beyond a certain point.[175] In the cumulative, such factors argue the need for a new policy approach, one that is more closely rooted in the human experience. Without accomplishing such a shift, efforts to regulate the corporation will continue to prove futile, perhaps even counterproductive, thus producing far fewer gains than costs.[176]

The previous section sought to demonstrate a sufficient rational basis as needed to justify, at a conceptual level, the inclusion of managerial virtue as a fundamental variable in the (corporate governance) policymaking process. (Whether or not it adequately achieved that objective is a different matter entirely). The discussion focus at this point changes, while the fundamental objective remains constant: to argue the need for a principles-based (versus a rules-based) approach to U.S. corporate governance policy.

Why Principles (over Rules)?

A salient feature of modern regulation is its unduly prescriptive nature,[177] reflecting a near obsession—one largely rooted in legalese—with particular means and ends. As it is presumed that an adequate rational basis exists as needed to justify the extant policy foundation, the actual problem focus is interpreted as a general inability to achieve the correct regulatory specification. This is to imply that all that stands between regulatory success and failure is the correctly specified model.[178] Thus, modern corporate governance policy seeks to proscribe very specific firm behaviors. For example, consider the painful series of attempts, over nearly a decade, to define, with any degree of accuracy, the term "materiality."[179] Thus a maniacal focus on the particular has caused modern corporate governance regulation to become increasingly rule-dominant,[180] which this discussion seeks to effectively argue against.

Consider that modern corporate governance regulation, as typified in Sarbanes-Oxley, compels the CEO to focus almost exclusively on the lowest common denomination in human behavior—the moral equivalent of a bowel movement—as part of an effort to decrease the future probability of corporate malfeasance. However, the actual effect—as witnessed in the 2008 corporate crisis—has actually been to encourage continuously greater displays of vulgarity and moral license.[181] Absent a cohesive and compelling vision, Sarbanes-Oxley–era regulation has failed to raise the moral tenor of corporate America.

Just as a morbid preoccupation with suicide is unlikely to help individuals who are psychotically depressed to recover, the obsession with "corporate excretion"—as representative of the lowest forms of human behavior—belies precisely the wrong telos. As a result, it is rendered incapable of motivating the executive to make the requisite and difficult commitment to eschew self-seeking in favor of the good and the best. Thus, modern policy is unable to muster a compelling argument—one that is grand, comprehensive, and cogent—as is needed to steer a corporation in the desired direction. This is to suggest that modern governance regulation fails to seek the common good, and thus provides little or no value to society.

Aristotle represents a reliable basis for construing an effective argument as to the need for a diametrically opposite, regulatory approach. This is to suggest that only through an appeal to the highest principles might it be possible to effectively motivate rational human beings.[182] Furthermore, through a primary reference to principles, versus an exclusive rule-reliance,[183] a clearly articulated and compelling vision is more likely to be possible.

Consider that the normative function of rules is to proscribe certain behaviors. Thus, it is immensely difficult to develop a positive message around a system of "thou shalt not(s) . . . " Conversely, principles are commonly stated as movements *toward* a particular telos. Thus, it is conceivable that a cogent system of well-articulated principles could support a positive and compelling vision, whereas the same conclusion does not apply to a system of rules. Hence, it seems entirely natural that the focus of the current, rules-dominant regime is unduly divisive and negative,[184] that its requirements have been shrouded in ambiguity,[185] or that it is broadly despised, despite having been generally tolerated.

To the degree that efficacious regulation requires willing cooperation—an important assumption that requires further explication—this discussion may be used to suggest that a principles-based approach is entirely necessary if U.S. corporate governance policy is to have any opportunity to succeed. Consider, for instance, that the New Deal legislation, despite containing a wide range of detrimental flaws, transformed America through an unabashed reliance upon a strong, clearly articulated, and positive message. In contrast the characteristically negative focus—for example, one that effectively implies that lurking within every CEO is an avaricious criminal[186]—inherent in modern governance policy appears eerily reminiscent of certain aspects of Anthony Burgess's *A Clockwork Orange*, suggesting an overall effect that is more destructive than it is immediately constructive.

Consider the basic statement, as posed in the prior paragraph, that efficacious regulation requires willing cooperation, upon which the entire argument in favor of principles seems to rest. Thus, it is immediately necessary to demonstrate a sufficient rational basis for this statement, as needed to justify it as fundamentally logical. In this regard, consider that an individual mastery of the virtues is incredibly costly, requiring no less discipline than is needed by the elite Olympian or the world-class concert pianist. Just as one does not begin the ascent to the summit of Mount Everest in shorts, tennis shoes, and a T-shirt, anything less than a full commitment to a life in the virtues is bound to fail.

Furthermore, to be virtuous requires a full-time commitment, thus implying that the moral, decision-making framework envisaged by virtue ethics is not *a* perspective, but rather *the* perspective.[187] Consequently, greatness—versus any smug sense of self-satisfaction that might be derived from rule-reliance—comprises the only pragmatic objective, if corporate virtue is to be realistically attainable. However, greatness, as it relates to an exercise of the virtues, is fundamentally at odds with rules, such that it may be achieved only through principles: There are no rules pertaining to greatness.[188] Thus, Aristotle emphasizes a normative role for guiding principles—as efficacious instruments of virtue—while eschewing a simplistic form of rule reliance, as its fundamental opposite.[189]

The salience of this distinction—for example, as, generally speaking, between rules and principles—to the role of the corporate executive may be readily demonstrated. Contemplate the immense demands that are placed upon the CEO, requiring a pronounced ability to function effectively amidst extreme chaos—as present both within and without the corporation—and to deliberate with sagaciousness in the most heated, tumultuous, and conflicting of circumstances. Rule-reliant governance structures,[190] as a function of their design, make it virtually impossible to perform such a task consistently well.

To illustrate, consider the degree—an important topic given greater attention in subsequent chapters—to which fundamental elements of the U.S. accounting orthopraxy, as constituted in U.S. GAAP (Generally Accepted Accounting Principles), appear bereft of either logic or of a conspicuous rational foundation.[191] The witnessed result has been an approach to corporate accounting that, in varying degrees, is unduly onerous, while offering relatively little of value to investors.[192] Add to this the fact that, in the era of Sarbanes-Oxley, executives must be increasingly wary about the very real potential of being held legally accountable for unintentioned errors.[193]

This is to suggest, under the best of circumstances, the sheer impracticality of rigid, one-size-fits-all rules that ignore the complex realities inherent to the corporate structure. That this conclusion may be reached independent of an analysis as to the rational basis underlying such rules attests to the strength of the argument.

However, an argument that leads, as a logical conclusion, to the sheer impracticality of rule-reliant regulatory structures, fails to constitute an argument for principles. Thus, it is necessary—as is the focus of the present discussion—to logically demonstrate the capacity for a principles-based approach to succeed where a rules-dominant approach would prove unable. Of immediate relevance to the corporate executive, the unique strength of a principles-based approach,[194] when properly accompanied by a series of clearly illustrated examples, is that it has the realistic ability to facilitate sound and prudential judgments, as needed to discern the optimal strategic alternative amidst circumstances that are inherently ambiguous.

In this regard, a critical advantage of a principles-based approach is its inherent flexibility. Under ideal circumstances, managers must have the autonomy to violate currently established norms in favor of more effective alternatives[195]—something that rules-based laws, as a defining characteristic of Sarbanes-Oxley, categorically prohibit.[196] Thus, Aristotle conceptualizes progress as occurring through both rule-keeping and rule-breaking.[197] This is to suggest that, contrary to the rigidity inherent in Sarbanes-Oxley, rules are not sacrosanct.

However, the law effectively criminalizes innovation, thus prohibiting firms from efforts to achieve greatness beyond what the rules prescribe. (That the law's telos appears, in truth, counterproductive, thus leading managers in the wrong directions, is another matter altogether). Furthermore, its appeal to the lowest common denominator in human behavior fails to provide any guidance to the vast majority of public firm executives who are not criminals, and who are motivated by something other than a banal desire to avoid scurrilous behaviors.[198]

As a result, the rule-reliant nature of modern corporate governance regulation has spurred widespread confusion rather than clarity.[199] This discussion may be used to suggest the critical advantages of a regulatory approach dominated by a reliance upon principles rather than rules. Although greater emphasis in this discussion, up to this point, has been afforded to the particular limitations and harms associated with rule-reliant structures, versus the potential benefits of a principles-based system, the specific arguments in favor of a principles-based system appear compelling nonetheless—a particular judgment that is better left to readers.

Another critical advantage of a principles-based approach to the corporate governance law is that principles are applicable to a wide variety of contexts. To the contrary, categorical rules are applicable to extremely limited and precisely defined circumstances. Research has suggested, for instance, that Enron failed to violate the accounting rules of its day,[200] though this did not stop lawmakers from creating new ones as a direct response. In fact, it is precisely because lawmakers cannot possibly envision every potential situation that managers will face that new rules have to be continually developed, so as to achieve ever greater specificity:[201] from Sarbanes-Oxley, to nearly a decade of painstaking efforts to provide a normative definition for "materiality," to (an equally inefficacious) Dodd-Frank.[202]

This discussion comports with Aristotle's belief that an effort to employ a precise set of rules for decision making is as futile as attempting to use a straightedged ruler to measure the outline of a fluted column.[203] Thus it may be argued that—just as the Greeks made use of flexible metal strips to measure curved spaces—the modern corporate executive has an unequivocal need for flexible rules, so as to permit effective decision making.[204]

However, at each turn, modern corporate governance regulation has only grown broader in scope, increasingly rigid, and more mercurial,[205] thus suggesting two potential concerns. The first is the likelihood that, as a natural response to the continual stream of new legislation, corporate managers may develop an overly compliant disposition—for example, to blindly follow without either questioning or seeking to understand. As a natural result, the fundamental process that is required for executives to grow in the virtues will be circumvented. As this effectively retards the growth of virtue, it equates to an invitation for more costly regulation in the future, and thus can be demonstrated as counterproductive.

The second outcome—as associated with the increasing scope, severity, and ambiguity of the regulatory effort—is the entirely inadvertent possibility that future violations will actually increase as a result,[206] due to the inherent limitations and harms associated with rules, as previously discussed at length. This is to suggest, as a logical conclusion, that the dramatic increase in U.S. corporate governance regulation, beginning with Sarbanes-Oxley, should not only be disconcerting, but defined as counterproductive. The array of documented outcomes associated with this development are negative rather than positive. Though not the focus of this particular discussion, it is a conclusion that receives strong empirical confirmation.[207]

Given that it is possible to logically demonstrate the superiority of principles over an exclusive reliance on rules in the corporate context, the discussion now turns to eminent, practical concerns—for example, what are the natural requirements of a principles-based approach to corporate governance regulation? To begin the discussion with a theoretical distinction, a transition—one previously argued as necessary—to a principles-based system would fail to constitute a reversion to the jurisprudence that preceded Sarbanes-Oxley, since it also was rule-reliant. Rather, such a transition would constitute nothing less than a fundamental paradigm shift in the evolution of U.S. corporate governance regulation.

To understand the logical steps required of such a transition, it is necessary to refer once again to Aristotle. Thus, the first step would require altering the normative telos associated with the corporate governance regulation by "translating" it into a general system of principles. The purpose is to ensure that executives now consider it a part of their professional duty to pursue ethical greatness, rather than to hide behind the rules. The second step would require the development, over time, of a comprehensive series of "best practices," as would be used to gradually replace a long-standing reliance upon prescriptive rules.[208] This fails to imply that rules would be dispensed with entirely—as reflecting some utopian misconception of human nature.

Rather, it signifies that the normative role that is assigned to rules would change significantly in two ways:[209] (1) an intuitive understanding would be developed that rules, which are of limited utility, pertain exclusively to the worst case scenarios, and (2) that rules fail to constitute a worthy objective for managers, given that their function is to address a minimal standard. (The latter condition is especially relevant, in that it implies that corporate executives would no longer have recourse to the rules as part of an effort to justify particularly egregious errors in judgment).

However, the general significance of this most recent discussion is to provide a basic demonstration as to the practical feasibility of implementing a principles-based approach. The discussion now turns to a focus on punishment, as a means of deterring regulatory violations. The primary argument, as contained in the following section, is that regulatory efficacy may be significantly enhanced through a clear emphasis on a desire to amend (i.e., correct) rather than to punish.

Why Amend (versus Punish)?

An important theme, as available through reference to Aristotle, addresses the critical importance of achieving a state of willing cooperation between the law[210] (e.g., regulation) and those who are subject to it—a particular outcome that might only realistically occur in the face of substantive and mutual goodwill.[211] This may be used to argue a need for a specific policy approach—for example, one diametrically opposite that taken by the 107th Congress—that may be characterized, to a degree that is likely to prove surprising in light of modern sensibilities, as according to its even-handedness and evident concern for those governed.

Consistent with this fundamental theme, Aristotle may be interpreted to suggest, as counterproductive, any system of arbitrary, inflexible, and punitive measures—a defining characteristic of regulation in the era of Sarbanes-Oxley.[212] Furthermore, there exists a fundamental, theoretical distinction between punishment, as favored by the 107th Congress,[213] and amendment, as favored by Aristotle.[214] Because the 107th Congress evidently sought to make an example of the corporate executive,[215] so as to resonate with fearful investors, a stringent policy was required, along with a dissonant and discordant policy approach.

However, the presence of a hypothetical link to effectively unite the most draconian punishments—for example, as depicted in the disturbing classic, Stanley Kubrick's film adaptation of *A Clockwork Orange*—to compliance is far from axiomatic. As a potentially more likely outcome, a dominant focus on punitive measures may prove counterproductive, in part by inducing a mechanistic, superficial form of compliance. Inadvertently, two deleterious outcomes may reasonably be expected as a natural result: (1) the growth of virtue, as previously discussed, would be deterred, thus contributing to a general worsening of the problem, as opposed to its solution, and (2) executives would be conditioned to view regulation, in general, with undue suspicion, as would contribute to regulatory inefficiencies (and therefore costs) in the future. Even if the brute force of the law succeeded in forcing compliance, it may still be argued that if "people are good only because they fear punishment, and hope for reward, then we are a sorry lot indeed."[216]

Thus the combative and discordant policy approach, as selected by the 107th Congress, as an inadvertent effect, invited fierce opposition from executives, whose willing cooperation is fundamentally necessary to achieve an efficient implementation of corporate governance regulation. This is to suggest that before regulators could focus on pursuing the actual policy objectives—with no clear guarantee of success—an emboldened opposition had first to be overcome, as through a compelling use of (legal) force. As a result, unnecessary costs and complexity were injected into the regulatory effort.

Thus, Sarbanes-Oxley's unduly onerous and rigid implementation was not merely inefficient—for example, producing costs over and above what they otherwise would have been—but it was arguably necessitated by an undue (legislative) emphasis on punishment, which effectively prevented the development of mutual cooperation. Ultimately, the punitive focus was misguided: The final bill was paid not by the CEO, who is wealthy by any comparison, but by the unsuspecting investor and taxpayer.

Mutual cooperation, as between corporations, policymakers, and regulatory officials, represents a minimal standard for the success of any corporate governance initiative. However, a fundamental prerequisite for the development of such an effective coalition is policy whose design is wholly purposive and thus carefully crafted, such that any negative incentives (i.e., punitive measures) present appear as just and beneficial to those governed. A reference to Aristotle may be interpreted as requiring an additional step: that the governed share a preference for (just) punishment over any potential for illicit gains, as might be received through shirking behaviors. This latter requirement likely seems foreign in light of modern sensibilities. However, as a fundamental principle, it receives an apt illustration from Shakespeare's Sir Thomas Grey, who states, upon being arrested for a treasonous plot against King Henry V:[217]

> Never did faithful subject more rejoice
> At the discovery of most dangerous treason
> Than I do at this hour joy o'er myself,
> Prevented from a damned enterprise.
> My fault, but not my body, pardon, sovereign.[218]

As understood in this context, the expectation is not for masochism, per se, but merely that the governed—in this case, the executive—be able to draw a clear distinction between an imposition of punishment that is capricious and arbitrary, and one that possesses a clear rational justification. Furthermore, this interpretation is consistent with a regulatory emphasis on amendment versus punishment. Placed in a modern context, this may be used to argue—as reflecting a minimal requirement for policy success—the clear need for regulation to be securely moored in a strong rational basis. It is to be expected that only a policy so constituted possesses a realistic opportunity to compel the type of allegiance, both from the regulator and the regulated, that policy success ultimately requires. Thus, considered apart from any purely rational considerations that might influence policy effectiveness, the aesthetic appeal of this framework—as rooted in Aristotle—appears luminescent relative to that employed by the 107th Congress.

This discussion is intended to suggest that Sarbanes-Oxley's failure—even apart from a careful evaluation as to the law's provisions—was at least partially rooted in the unduly acrimonious policy approach adopted by the 107th Congress. At the very minimum, it suggests that the tenor of the regulatory effort, in that regard, was counterproductive. Consider that the public corporation, as a preeminent institution inexorably linked to the American tradition, may be generally considered one of the few remaining bastions of American exceptionalism. By vilifying the CEO as the enemy of the common good, the natural telos of corporate governance regulation has been obscured, thus encouraging acrimony, divisiveness, and—as a less obvious result—a general distrust of the law.

The final result is that corporate America clearly lost, as did the individual investor, whereas the average American suffered the consequences of a downturn in the U.S. and global economy. (Ironically, it may be argued that even Sarbanes-Oxley lost, due to a pronounced inability to achieve its objectives). Given that the purpose of this discussion was to provide a compelling, rational argument as to the need to orient policy away from an overtly punitive focus, the discussion may now proceed to the next basis.

Policy Framework (Summary)

This discussion focusing on the policy framework possessed two core objectives: (1) to illustrate the rich conceptual differences—in terms of an understanding of virtue, principles, and amendment—between a modernist perspective, as reflected in U.S. corporate governance regulation, and that of the ancients, as based upon an interpretation of Aristotle; and (2) to provide a compelling, rational argument for a fundamental (paradigm) shift in the modern policy framework, as needed to attain efficacious corporate governance regulation.[219]

The revamped framework, as briefly argued, would incorporate, as constituent model elements, acknowledgments both as to a normative role for virtue,[220] and as to the general efficacy of principles (versus an exclusive rule-reliance), in addition to an enhanced focus on amendment—as needed to achieve cooperation—versus punishment. Despite the fact that the immediate implications posed by this argument are clearly pragmatic, its primary focus is theoretical. As a result, the immense practical difficulties that are likely to be encountered by any practical effort to achieve such a deeply rooted, conceptual transformation are not addressed by this discussion.

Consider, for instance, that a fundamental philosophical shift of this nature—presuming it was to be desired by society—is unlikely to be viewed without at least some suspicion. A normative role for virtue (ethics) under the revamped policy framework would likely receive the fiercest objections. Whereas some of these protests would undoubtedly reflect practical concerns—for example, as reflecting the inherent difficulties of establishing a policy framework in which virtue, per se, plays a normative role—it is the connotative aspects of virtue that would likely precipitate the most contention.

Consider also that the achievement of a normative role for virtue—for example, as representing not only a practical concern in the daily life of the individual, but also a prerequisite for the attainment of the good life—represents a clear contribution of the Judeo-Christian intellectual tradition.[221] Thus, it is not lacking in religious connotations. Consequently, a conceivable objection might be that the injection of virtue—no matter how it is defined—as a facet of modern policy represents a (artificial) conflation between the religious domain and the modern regulatory effort, such that it contradicts modern sensibilities.

However, the validity of such an argument arguably rests upon a particular conception of virtue that is foreign to the policy arena. As a result, an effort to incorporate virtue into the policymaking framework would, by definition, seem contrived or artificial. However, the fundamental premise on which the argument rests is flawed. Scholars have long affirmed the degree to which regulation is inherently value-laden, to the extent that it has come to reflect dominant societal values,[222] whereas values represent a primordial concern of virtue ethics.

Thus the argument based upon a conception of virtue that is artificial to the policy environment fails. Clearly other arguments are possible. Perhaps a more compelling, and eminently practical argument may be rooted in the observation that, at a fundamental level, ethical norms increasingly appear to be at odds with modern American culture. Thus, any move to embrace ethical norms vis-à-vis corporate governance policy would likely prove controversial,[223] and thus be difficult to achieve—a particular concern that would have to be addressed should it ever become necessary.

Consider that the primary purpose of this initial discussion focusing on policy framework was to argue the need for a deeply rooted shift in the modern corporate governance policy foundation in a very specific direction. Consistent with the broad, conceptual-level focus of this introductory chapter—whose primary purpose is to set the stage for the remainder of the discussions contained throughout the book—is the implied significance of achieving a lucid understanding of the potential for virtue vis-à-vis the modern corporate environment. Because corporate governance regulation is dominated by ethics concerns, such a discussion is entirely necessary if policy is to be oriented toward the appropriate telos. As a result, the equally broad focus of the next discussion is to enhance a more lucid understanding of the somewhat nebulous term, *corporate ethics*.

CONCLUSIONS

This chapter sought to introduce a broad framework from which to analyze modern U.S. corporate governance regulation. The focus is both introductory, in that it seeks to provide readers with a conceptual level understanding as needed to benefit from the applied analyses presented in the remainder of the book, and analytic, in that it seeks to provide unique insights as to the nature of the problem, as well as a basic framework for understanding the various agents of causation, in addition to illustrating, at a very broad level, specific means of improving the extant regulatory framework, as is needed to increase its overall stability and efficacy.

Consistent with contemporary authors—for example, Karl-Heinz Brodbeck[224]—who employed alternative frameworks so as to advocate a fundamental paradigm shift in the treatment traditionally afforded to modern economics, both the perspective employed (e.g., as fundamentally relying upon Aristotle) and the insights produced are novel. The specific insights afforded are intuitive and lucid, thus effectively highlighting critical sources of regulatory inefficiency in the modern era, effectively demonstrating the need for a fundamental paradigm shift. The degree to which this brief discussion, as rooted in Aristotle, succeeds in illuminating the general character of U.S. corporate governance regulation in the era of Sarbanes-Oxley offers a vivid demonstration as to the timeless relevance of the ancient philosopher.

Proving, through a series of comprehensive analyses, that Sarbanes-Oxley does not—and cannot by its very design—function as intended, is a less than satisfying conclusion. A more ambitious task remains: that of discovering the rubric of an alternative framework—one not yet considered by regulators—that carries with it a realistic potential for reintroducing virtue in civic life, and especially within the public corporation. Aristotle's theories have proved to be uniquely relevant to this context, due to his overriding emphasis upon virtue and ethics, and due to the significant impact his thoughts have had on contemporary studies of business ethics.

This analysis uncovers stark differences between the modern regulator, on one hand, and Aristotle, on the other, in terms of how each conceptualizes three key variables: (1) a normative role for virtue, (2) the significance of principles (versus rules), and (3) the proper role of punishment. Aristotle (and thus virtue theory), not so surprisingly, place central significance on the role of individual moral excellence. Applying this framework to the subject of corporate ethics may suggest that individual virtue—or its lack thereof—serves as the primary causal agent influencing the quality of managerial decision making. Virtue is not automatic to the individual, but rather requires significant training and expertise to cultivate.

Conversely, modern corporate governance regulation, as derived almost exclusively from social science theory, is predicated upon the modernist assumption that managers, as self-interested agents, approach decision-making contexts as an intricate series of cost-benefit analyses. While this factor is often overlooked, this is to blithely presume either the nonexistence of virtue, or that for all practical purposes it is unattainable to the individual. Such a distinction is critical, because it leads to two important conclusions that otherwise would not be tenable: (1) that the objectives of the individual executive and those of the law are diametrically opposed, thus mandating a remedy in the corporate governance law that is both formally prescriptive and unduly harsh, and (2) that managerial virtue—because it has been defined not to exist—cannot be cultivated, thus effectively relegating regulatory efforts to an exclusive focus on "corporate excrement"—fraud, embezzlement, and other behaviors representative of the lowest common denominator—since any other approach would be understood as futile.

Another critical difference is that Aristotle emphasizes principles over legalistic rules as an efficacious means of inspiring ethical greatness. As discussed previously, the exclusive value of rules is in their ability to address the lowest common denominator in human behavior. As a result, an exclusive reliance upon rules—for example, as found in Sarbanes-Oxley–era regulation—is contraindicated as a means of incentivizing the behavior of powerful executives who control many billions of dollars in investor-owned capital.

The highly prescriptive and dominant rules-based focus of modern U.S. corporate governance regulation is a recipe for a bureaucratic nightmare: New rules will continually need to be devised and enforced, as a means of responding to the most recent crisis. Countless resources will be wasted in the pursuit of fantasmal benefits that, by definition, can never be achieved: a dog in rapid pursuit of its own tail. All the while, the needs of the overwhelming majority of corporate managers—for example, for instruction and guidance in their pursuit of the excellent—are continually unmet. This is to suggest that modern corporate governance regulation is a recipe for failure by design: Repeated policy failures are as much (if not more) a reflection of fundamental flaws in regulatory design, as they are of the intransient nature of the problems they seek to address.

Critical differences also exist in terms of the role of punishment. Aristotle may be interpreted as suggesting two key points: (1) that punishment should educate and uplift rule violators, and (2) that good law, by virtue of being good, need not rely upon the threat of punishment to enforce compliance. Conversely, a major premise of US regulation, as reflected in Sarbanes-Oxley, is that it is (only) the "sharp whip" that has an ability to motivate change in the desired direction.

Thus, as a logical result of an apparently erroneous belief, corporate executives—individuals who, according to the dominant interpretation, would naturally seek to defraud investors were there not an effective counterbalance in the law—must be forcibly subdued, such as through bullying, intimidation and threats of reprisal. Hence, an effective deterrence against egregious rule violations requires an unyielding and dominant master, a role that has been filled by the PCAOB in conjunction with the external auditor.

Consistent with this conceptualization of social causation, Sarbanes-Oxley resulted in a significant alteration of the mens rea standard: CEOs, for the first time in U.S. history, can now be held criminally liable for specific outcomes they neither intended nor possessed any prior knowledge of. This represents a noteworthy example of the modern phenomenon of "defining deviancy up,"[225] where behavior long considered benign is redefined as abhorrent or even criminal. No longer is it sufficient "for the deviant to be normalized. The normal must be found to be deviant."[226] The objective, as successfully achieved, was to inspire among corporate executives a morbid fear of regulatory officials, as well as to present bourgeois society as thoroughly corrupt, as consonant with an overall effort to alter the precise ordering of societal values, which has only caused rampant confusion.

Of paramount concern is which perspective offers a more stable, efficacious platform upon which to base the future of U.S. corporate governance regulation. Ultimately this depends upon which portrayal of human behavior is more realistic. The conclusion is also likely to depend upon the particular assumptions made. For instance, it is worth noting that modern corporate governance theory blithely insists upon the nonexistence of virtue, a refusal, as peculiar to the modern epoch, which lacks any apparent rational basis. However, because it is *assumed* to be true, no formal proof has been required—nor has any been offered—as to its tenability.

However, its importance transcends that of mere assumption: The success of a sequence of comprehensive regulatory efforts—from Sarbanes-Oxley to Dodd-Frank—is almost wholly reliant upon its veracity. At the bare minimum, common, everyday experience seems to offer a convincing argument not merely as to the significance of virtue, but as to its ability to exert a causal influence upon human behavior. A second factor is the proven inability of modern regulation—as evidenced in Sarbanes-Oxley—to achieve its designated objectives—a particular topic addressed at length in subsequent chapters. So great is the chasm between the intended outcomes and those actually achieved, that it may be reasonably argued that better results might be achievable were the regulatory development process completely random.

This is to argue that the modern framework for establishing corporate governance regulation, as predicated upon an understanding of human behavior that bears little or no resemblance to nature, is irrevocably flawed. In comparison, the general framework proffered by Aristotle[227] seems far more capable of accounting for the complexity that is typically replete in scenarios pertaining to managerial decision-making and the modern corporation. Thus, a primary purpose of this introductory analysis is to argue the need, at a very fundamental level, for a wholesale paradigm shift—one that permits the current conceptualization of human behavior to give way to a more realistic model, as needed to facilitate the development of efficacious corporate governance regulation.

To be clear, this discussion does not presuppose that *the* definitive solution to the various problems posed by the noted failure of Sarbanes-Oxley–era regulation can be achieved through an exclusive reliance upon Aristotle. Rather, it seeks to eschew the ongoing, divisive, and polemicized debate over the future of U.S. corporate governance regulation in favor of achieving a rational discourse at a philosophical level of inquiry.[228]

The detailed examination of competing frameworks and contradictory assumptions effectively reduces the pronounced and noted tendency—as a prominent feature of the debate—to rely upon fideism, just as it demonstrates the sheer futility of an analytic approach that relies exclusively upon econometric analyses. This is to suggest the need for a fundamental paradigm shift not only in terms of regulatory models—as based upon a new conceptualization of human behavior—but also in terms of those specific analytic methods that may be considered natural to the policymaker.

Consider that critical policy debates—which, in the modern era, all too frequently are accompanied by dysfunctional tactics and relatively hollow arguments—tend to be intractable, and thus are inexorably resistant to neat resolutions. Instead, they tend to linger and to fester (the New Deal and the Vietnam War comprising two salient illustrations). Hence, apart from seeking insights that might effectively pave the way for the development of efficacious regulation, this analysis also seeks to facilitate a fecund policy dialogue by inviting an ancient scholar to serve as arbiter.

The various arguments contained herein ultimately may not prove sufficient to alter individual perceptions as it pertains to U.S. corporate governance regulation, nor is persuasion the dominant focus of this book. Rather than address the specific content of individual belief—for example, how one views Sarbanes-Oxley—emphasis is afforded to encouraging both the development as well as a conceptual-level appreciation of the operative factors that motivate individual beliefs. As a result of a pronounced emphasis upon rational argumentation—as opposed to policy rhetoric—a hollow and empty dispute may be transformed into a fecund policy debate, thus encouraging the development of regulatory efforts whose rational basis is demonstrable and clear.