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Exploring Ethical Implications of Personal Relationship in Dyadic Business Exchanges

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ABSTRACT

This paper explores the ethical implications of the existence of personal relationships in business exchanges. Firstly, this paper introduces personal relationship in business exchanges. Secondly, three normative theories of business ethics that are related to the issue of personal relationship are presented. Finally, this paper explores the ethical implications on personal relationships according to the three theories. The main recommendation of this paper is that an analysis of personal relationships using ethical theories is needed to formulate laws and regulate such relationships and ultimately eliminate their negative consequences on organisations' profitability.

INTRODUCTION

In a dyadic business exchange environment, the relationship between two organizations is basically between two agents, and the relations can be a of a personal-relationship nature as the business relationship may grow to become personal one with time. On many occasions, in spite of the personal nature of the relationship, interacting agents are still able to coordinate their actions to bring economic benefits to their organizations.

However, the fact that selfish behavior of an agent may put his or her personal interest before the organization's benefit, demands the investigation of the loss of collective welfare due to selfish and uncoordinated behavior. Recent research efforts have focused on quantifying this loss for specific environments; the investigation of price anarchy has provided a number of measures by which is it possible to design social systems with robustness against selfish behaviors (Jensen, 2002; Namatame, 2006).

Structure of this paper: Section 2 presents some basic issues related to personal relationship in dyadic business exchanges. Section 3 explores the role of ethics in business environment by using a framework of constraints that regulate behavior of interacting agents. Section 4 presents three normative theories of business ethics that are related to the issue of personal relationship, and investigates the ethical implications on personal relationships according to the three theories.

PERSONAL RELATIONSHIP IN BUSINESS EXCHANGE

Business relationships (or relational contracts (MacNeil, 1980)) develop between organizations described as collective units on inter-organizational level, are only for the economic benefits of the organizations involved. Personal relationship or loyalty between two agents from otherwise independent organizations, may compromise the respective organizations interests (Jensen, 2002). The problem of loyalty is especially sensitive in contexts where the individual agents hold high-trust-posts (Giddens, 1991). High-trust-posts involve tasks that are executed beyond the direct surveillance of the central leaderships of organizations. In this case, the personal relationship between the individual agents becomes the decisive factor of the business relationship between the respective organizations. Thus, personal relationship can hamper economic profits that can be derived from the business exchange between the organizations.

The Time Factor

Personal relationship, stand alone or part of business relationships, take time to develop; see figures 1 and 2. When business relationships are to be developed quickly, the quality of personal interactions (relationships) may suffer due to stressful environment of relationship acceleration (Wilson, 1995); this phenomenon is also known as "time-compression diseconomies" (Dierickx and Cool, 1989).

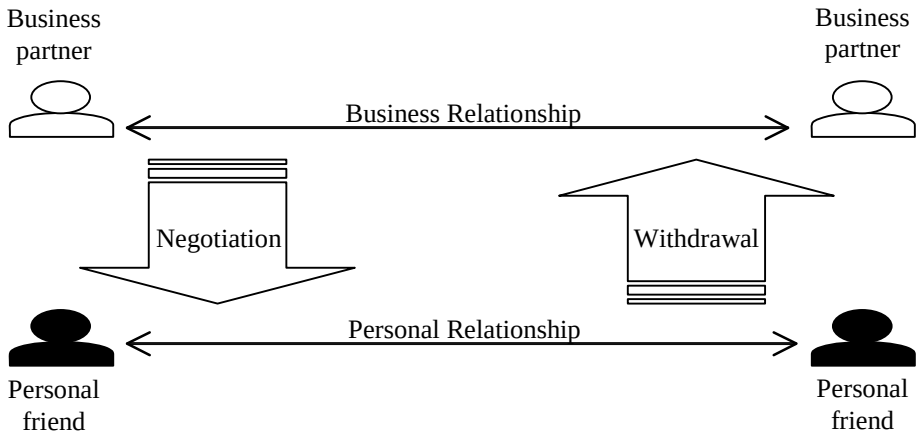


Figure 1: Personal relationships in business exchanges

Switching Cost

Personal relationship can also bring a business relationship to a stalemate at which conclusive decisions has to be taken whether to continue or discontinue the business relationship. The most important factor to be considered at this point is the cost of quitting (or switching cost) (Jensen, 2002).

Switching a business exchange relationship based on individual social contracts is considerably lower than for inter-organizational long-term commitments, such as strategic alliances. Relation-specific investments are first of all to be found in human asset specificity of the agents linking the organizations. The highest switching cost of individual social contracts is most likely to be as social costs between the individual agents involved. On organization-level these inter-personal costs are normally to be judged as low; however, there is no tool available to help an organization measure the switching cost of quitting a business exchange relationship that is dominated by personal relationship. Literature provides no mathematical models for this purpose; Lack of mathematical models for this purpose is mainly due to the adaptive nature of the economic agents and the uncertainties involved, and due to the complex nature of personal relationships involving huge number of parameters drawn from psychology, sociology, to management and economics.

Guanxi

Guanxi is a special case of personal relationships in business environment. The importance of developing personal relationship ('guanxi' in Chinese) in order to conduct business in China is well documented (Li and Wright, 2000).

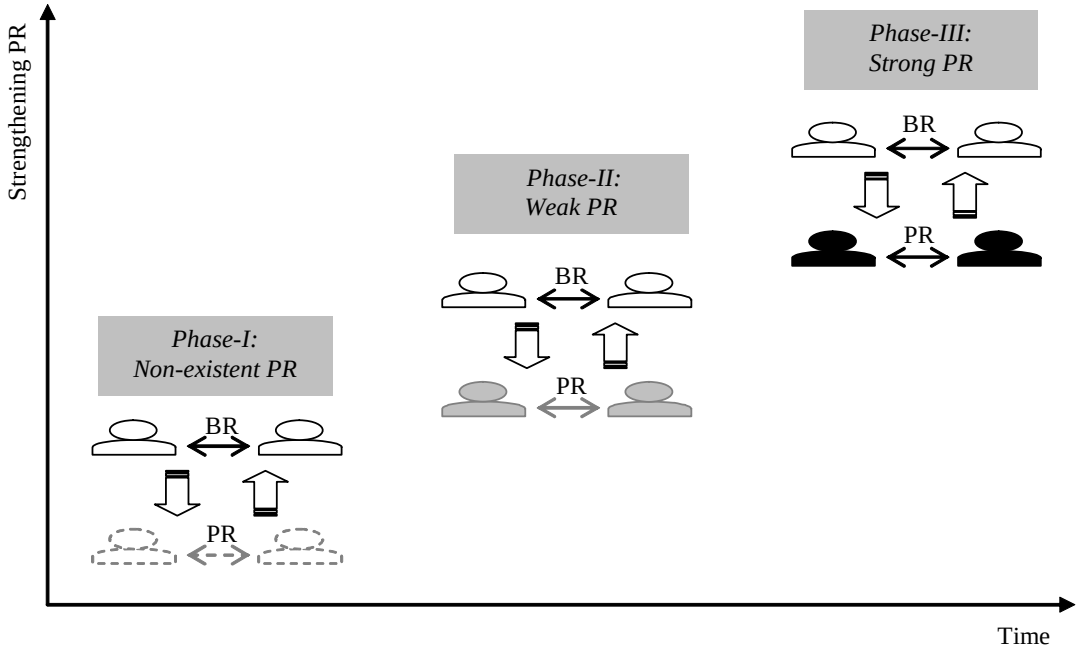


Figure-2: The time factor in establishing Personal Relationship (PR)

We say guanxi is a special case because in the guanxi system, there must be personal relationship *before* the business relationship can foster. However, in this paper, we focus on the personal relationship that develops because of the established (long-term) business relationship in an open market environment; see figure 2. As shown in figure 2, in the beginning, the relationship between two interacting agents is purely a business relationship; after long-term interactions, personal relationship can foster between the two agents, and if the personal relationship becomes the decisive factor in the business relationship, then we have a guanxi between the agents. In other words, with time, we move from open market system to guanxi system.

A closely related issue is the organization-to-organization relationship (or inter-organizational guanxi, popularly known as the "keiretsu", in Japanese language). In keiretsu, the "personal relationship" is not at the personal level, but at the organizational level (Miyashita and Russell, 1995).

THE ROLE OF ETHICS IN BUSINESS ENVIRONMENT

This section presents some basic concepts that will enrich our moral assessment of the issue of personal relationships in business exchanges. In the following section a concise overview of the ethical theories that can guide our analysis. But first, the role of ethics is presented in this section.

In business environments, there are many constraints that can guide and shape business transactions. Lessig (1999) presents a framework describing four constraints that regulate the behavior of cyberspace activities. Though the constraints are applied to cyberspace setting in Lessig (1999), we find it very relevant to general business environment; given below is our interpretation of the four constraints applied to business environment:

The first constraint is the law. Laws are rules or commands imposed by the government that are enforced through ex post sanctions; ex post sanction means that law retroactively makes criminal conduct not criminal when performed, but increases the punishment for crimes already committed. The second constraint is the market. The market regulates through the price it sets for goods and services. Unlike the laws, the market forces are varying and not fixed expressions. In addition, the market forces are imposed immediately and not in ex post fashion.

The third constraint is the code (*aka* architectural constraint). The architectural constraints are physical constraints, natural or man-made, restricts the freedom of business transactions. For example, if two interacting agents, residing in geographically distributed places, were to agree to a business deal over the telephone, then they must be available at the same time; in addition, they are obliged to document the verbal agreement in some robust way. If they decided to send the agreement as an email attachment, then they are obliged to use some digital signature to authenticate the document. In both ways, there are some restrictions.

The fourth and final constraint is the social norms. Social norms are informal expressions of a community that

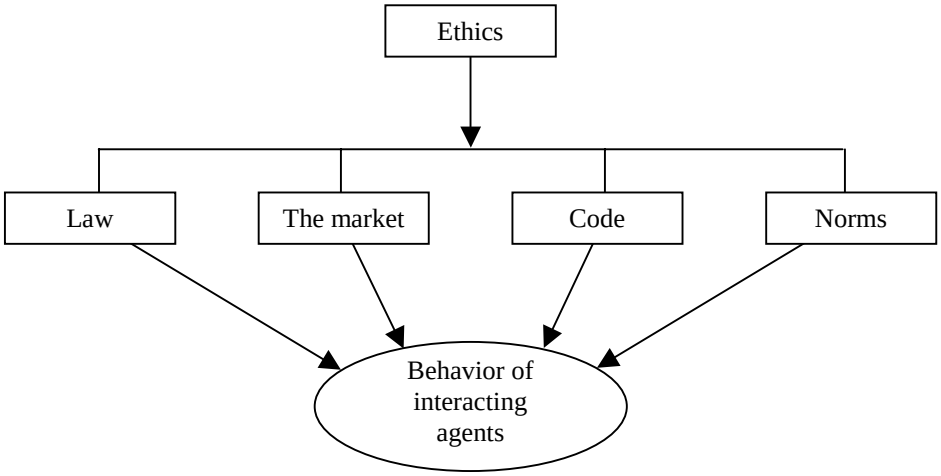


Figure 3: Constraints on interacting agents behavior in business exchanges
(adapted from Spinello (2003), Lessig (1999))

defines a well-defined sense of normalcy and expects the members of the community to follow. An example for social norm under business context is the dress code.

Where do ethics and its role fit into this framework? Lessig (1999) included ethics under the broad category of "social norms". Spinello (2003) argues that the fundamental principles of ethics are metanorms and they have universal validity, and hence should not be classified as social norms that have only cultural or community value. The modified framework by Spinello (2003) is shown in figure 3. In figure 3, ethics is given a *directive role*, that is, ethics should guide and direct the ways in which the constraints such as laws, the market, code, and social norms, exercise their regulatory power. By giving ethics the directive role, the revised framework emphasize the value of human flourishing as the ultimate constraint on the behavior of the interacting agents, and hence on business transactions, assuming that the ethical theories are for human flourishing.

INORMATIVE ETHICAL THEORIES

Literature provides meticulous works on ethical theories applied to business exchanges, e.g. Li and Wright (2000), Lovett et al (1999), Fan (2002) and Steidlmeier (1999); see Pearlson and Saunders (2006) for a summary of the works. However, the aim of this paper is to explore the implications on personal relationships.

Three theories of ethics are applied in business environments. These are *stockholder theory*, *stakeholder theory*, and *social contract theory*. These theories are called normative theories as they are prescriptive ethical principles for business environment and described in language accessible to the ordinary businessperson (Smith and Hasnas, 1999; Pearlson and Saunders, 2006). These theories and their interpretations and implications are given below:

Stockholder Theory

According to the stockholder theory, the stockholders contribute capital to the businesses and corporate managers who act as agents in advancing the stockholders interests (Pearlson and Saunders, 2006). According to the originator of this theory, the only social responsibility of business and hence the agents, is to use the resources to engage in business activities designed to increase profits for the stockholders; profit making must be done by open and free competition, without deception or fraud (Friedman, 1962; Pearlson and Saunders, 2006).

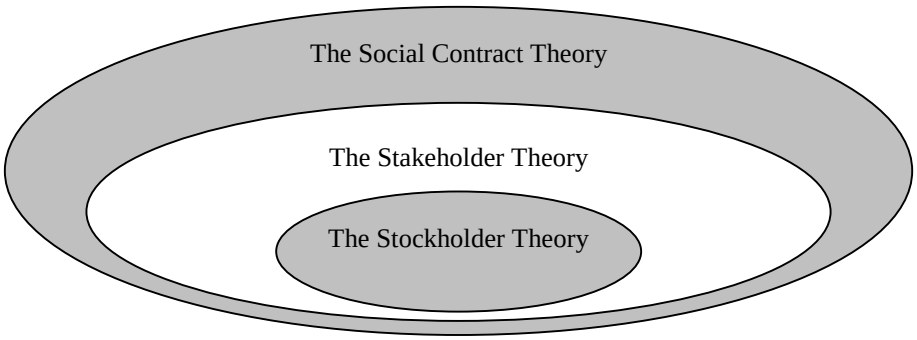


Figure 4: The relationship between the three normative theories

Stakeholder Theory

According to the Stakeholder theory, in addition to the obligation to the stockholder, agents are also responsible for taking care of the interests of *all the stakeholders* of the business; the term stakeholder refers to any group that vitally affects the survival and success of the corporation (e.g. employees, suppliers, distributors, customers) or whose interest the corporation vitally affects (e.g. the local community, customers) (Smith and Hasnas, 1999). This means, unlike stockholder theory that primarily look into the interests of stockholders, stakeholder theory balances the rights of all stakeholders (Pearlson and Saunders, 2006).

4.3 Social Contract Theory

Stockholder theory and stakeholder theory do not talk about the society; according to the social contract theory, agents are responsible for taking care of the needs of a society without thinking about corporate or other complex business arrangements. Social contract theory forces the agents to interact in a way that brings benefits to the members of a society. Hence, society can grant legal recognition ('social contract') to a corporation to allow it to employ social resources toward given ends (Smith and Hasnas, 1999). The social contract allows a corporation to exist and demands that agents create more value to the society than they consume for the business interactions.

The social contract comprises two distinct components: the social welfare component and the social justice component. The social welfare component imposes that businesses must provide greater benefits than associated costs to a society, inclusive consumers and workers. The social justice component imposes that businesses must pursue profits legally, without fraud or deception, and avoid activities to injure society.

4.4 Ethical Implications of Personal Relationships

By skimming through the normative theories of business ethics, one can see that these three theories related. The social contract theory is the most restrictive one, demanding that the whole society should be taken care of by the interacting agents when they conduct business exchanges. The stakeholder theory is lesser restrictive than the social contract theory, as instead it demands that all the stakeholders of the business (not the whole society) should be taken care. And finally, the stockholder theory is the least restrictive one, as it demands that only the stockholders are to be taken care of by the agents. Figure 4 depicts the relationship between the three normative theories due to their extensiveness in covering the elements of a society.

Is the existence of personal relationships ethical or unethical? From figure 4, one would expect that it is only necessary to check against the social contract theory as it is the most restrictive one. If personal relationships are unethical under social contract theory, then it would seem also unethical under stakeholder and stockholder theories. However, closer scrutiny presents a different account:

By the stockholder theory, any business interaction between the agents that does not profit stockholders is unethical. Hence, it is not unethical to establish personal relationships between the interacting agents, assuming for instance personal relationships profits stockholders by reducing the transaction costs. However, the most important issue that speaks against personal relationships is that stockholder theory assumes the free market system as the domain to conduct business exchanges; personal relations and it effects on business relations are not the elements of free market, thus unethical.

By stakeholder theory, personal relationships in business exchanges present more complex ethical issues. The main issue is how much benefit accrues to stakeholders from the personal relationships between the interacting agents; Does personal relationships favor a group of stakeholders (e.g. shareholders and some employees inclusive the concerned agents) and harm other stakeholders (e.g. the consumers of the business). Generally, assuming that all the stakeholders of the business benefit (or rather, not harmed) from the existence of personal relationship between the interacting agents, establishing personal relationships would not violate ethical standards, as they are understood under stakeholder theory, unless it could be shown to outweigh the benefits of any stakeholder.

By social contract theory, the interacting agents must ask themselves whether existence of any personal relationships could compromise fundamental tenets of fairness or social justice. If society seems to loose at contemporarily or in future due to the existence of personal relationships in business exchanges, then personal relationships could be seen as unethical. If, on the other hand, the established personal relationships seem to net a benefit to society, then it could be considered ethical.

CONCLUSION

As Aristotle saw it, ethics is action, not knowledge (Ross, 2000); in this paper, we are trying to use ethical theories to investigate whether personal relationships between interacting agents in business exchanges can be justified. We used a framework where ethics is given a directive role, on top of the regulative forces such as law, the market, code, and norms. We used three types of normative ethical theories (such as stockholder theory, stakeholder theory, and social contract theory) to analyze the issue of personal relationships. The three ethical theories determine personal relationship is ethical or not based on the net economic benefits to stockholders, stakeholders, and to society, respectively. To calculate the net economic benefits, we need mathematical models that use huge number of parameters due to the complexities in modeling the interactions between the agents; some of the parameters are (stated in section 2) the time factor and the switching cost.

Based on the analysis given in the previous section, it is clear that making a judgment about whether personal relationships in business exchanges are ethical or not is no easy task, as we lack mathematical models to calculate the economic benefits to different parties concerned. We are simply claiming that a through use of ethical theories as a guide is necessary in order to formulate laws and market regulations to regulate the effect of personal relationships. Formulation of the regulations is further complicated by the issues like respect to basic human values such as freedom and privacy, etc.

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