The value of morality

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Last week I attended the 2019 Global Dialogue held by Caux Round Table. We discussed the role of corporations, the need for new methods in assessing valuations and the risks that can result from a lack of moral capitalism.

Despite the event being described as 'global', Islamic finance was not part of the discussion. I am working with a group to bring that discussion to Malaysia in an upcoming meeting to ensure moral capitalism is compatible with Islamic guidance. At the same time, I believe people in Islamic finance will have important insights about moral capitalism.

In my opinion, people of every faith should see moral capitalism as compatible with the teachings of their respective faiths.

We also must understand that a specific faith may have additional guidance or religious law, eg Shariah has specific prohibitions on Riba.

That said, we should focus on the ideas that we share, while respecting each other's specific guidance or religious law. In doing so, we can work together more effectively and have greater influence in order to make the world a better place.

Despite the morality inherent in Shariah, corruption still exists in the Muslim world (as it does everywhere). Good governance implemented to achieve moral capitalism will help reduce both the frequency and severity of corruption. Good governance reduces opaqueness. When others can see one's behavior, one is less likely to do bad things. When bad things do occur, the bad things are discovered earlier.

An example of this is Volkswagen, a major car manufacturer. The company has been successful for many years. However, back in 2015, the diesel emissions scandal became public.

The company was accused of using software to fool emissions tests. The origins of the scandal date to 2006 when a new two-liter diesel engine did not pass emissions tests.

I believe that a good board of directors would have rejected a plan to commit fraud. The reputational damage done to the company has been catastrophic. Governance deficiencies existed in key parts of Volkswagen.

Bad decisions were made, and such decisions appear to have been kept from the board of directors. Consequently, there was a major impact on the company and its valuation.

Volkswagen is far from the only company to have had such scandals. Back in the 1970s, Ford, another major car manufacturer, had a high-profile scandal involving the Pinto car.

The design of the Pinto placed the gas tank in a location where a crash created a risk of explosion. When the defect was discovered, Ford leadership asked management, finance experts and engineers to recommend what should be done.

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The cost to move the gas tank was estimated to be US$137 million. At the same time, the 'economic cost' of the deaths and injuries from exploding gas tanks was projected to be US$49.5 million, meaning it was 'cheaper' to not fix the problem. Again, governance deficiencies fostered adverse consequences for the company's reputation, brand and image. If good governance had existed within Ford, perhaps there would have been a different and better outcome.

Sometimes even well-run companies have issues. Starbucks recently dealt with a racial issue in its stores. The company leadership responded quickly and forcefully; policies were changed and job training was conducted to correct the situation. Prior goodwill built among its excellent customer relationships enabled the company to overcome the issue quickly and without lingering effects.

Good governance helps to identify problems early, allows rapid intervention and strengthens the relationships with stakeholders — customers, employees, the general public and the company itself — to reduce the risk of the issue lingering. Simply put, good governance reduces the impact of negative issues when they do occur.