



# Business Ethics

A Stakeholder & Issues Management Approach

5e

Joseph W. Weiss

# Business Ethics

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# Business Ethics

## A Stakeholder and Issues Management Approach with Cases

Fifth Edition

Joseph W. Weiss  
Bentley College



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**Business Ethics: A Stake-  
holders and Issues  
Management Approach,  
Fifth Edition**

**Joseph W. Weiss**

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# Preface

Visit a major news Web site, read any major newspaper or business journal, turn on any major broadcast network like CNN, or tune into satellite radio news, and you will find an event, a crisis, or an issue that relates a corporation's activities to ethical issues and implications. Whether it is the subprime lending crisis, a global climate change, the fading middle class in America, a major political figure who has violated public trust, or events in China and India that affect the U.S. economy, questions quickly arise: Who is right? Who is wrong? Does someone stand to gain or lose? Was someone hurt? Who is liable? Should someone pay damages? Who acted responsibly? Who did not? Will justice be served? And, perhaps, how does this affect me, my work, and my life?

Business ethics is about relationships, values, justice, and identity (personal, professional, corporate, national, and global). It also concerns the intersection between business and ethics and is fundamental to the relationships between business and society at large. Why does the modern corporation exist in the first place? What is its *raison d'être*? How does it treat its stakeholders? Business ethics engage these essential questions, and it is also about the purpose, values, and transactions of and between individuals, groups, and companies and their global alliances.

With this in mind, students and professionals need straightforward frameworks to thoughtfully and objectively analyze and then sort through complex issues in order to make decisions that matter—ethically, economically, socially, legally, and spiritually. The post-9/11 world is different. Potential terrorist threats, ongoing corporate scandals, security issues, globalization, off-shoring and outsourcing, and what types of work and jobs will be available for graduating students and those returning for advanced degrees all present business and ethical issues that can and do affect our professional and personal relationships, careers, and lives.

## ***BUSINESS ETHICS, FIFTH EDITION:* WHY AND HOW THIS TEXT IS DIFFERENT**

This text remains a leader in the field, and this edition builds on previous success factors:

1. Easy to read and apply concepts and methods
2. Interesting news stories, exercises, and examples throughout the text
3. One of the most comprehensive sections on the market: in-depth, real-time **customized cases** (twenty-four in this edition) designed for this book
4. **Ethical dilemmas** that have happened to real people, not hypothetical stories



5. Best section on the market on stakeholder and issues **methods** with **step-by-step explanations**, not summarized abstractions
6. A **business, managerial perspective** with the latest research, not only a philosophical approach
7. One of the most comprehensive chapters on the market: Chapter 7 is devoted to updated information and data on **specific workforce/workplace trends** and issues
8. Comprehensive coverage of Sarbanes-Oxley, federal sentencing guidelines, and codes of conduct
9. Personal, professional, organizational, and global information and strategies offered with the latest research

## THE NEW REVISED FIFTH EDITION

This fifth edition of *Business Ethics: A Stakeholder and Issues Management Approach* adds features that enhance your ethical understanding and interest in contemporary issues in the business world. This edition also aligns even more closely to help students, managers, and leaders achieve international AACSB requirements in their respective fields. Here are the new and revised changes:

- Eight chapters instead of seven; the eighth chapter expands global and international business topics, including a case on China, India, and Google in China
- Twenty-four cases, almost all of which are newly created for this text
- New national ethics survey data is included throughout the text, starting with Chapter 1
- New perspectives on generational differences and ethical workplace issues have been added to Chapter 6
- Each chapter has new and updated lead-off cases and scenarios to attract students' attention
- Expanded coverage of corporate governance laws and values-based methods
- Updated research and business press findings and stories have been added to each chapter to explain concepts and perspectives

In addition to providing concrete frameworks for analyzing and discussing a wide range of ethical issues, the fifth edition of *Business Ethics* also includes a full complement of tools for leading discussions and encouraging student participation:

- Highlighted ethical dilemmas (several are new to this edition) underscore the fact that difficult business decisions are grounded in ethical dilemmas. Each dilemma asks students not only to make a choice, but to defend their decisions and to consider the consequences that inattention to the ethical implications depicted might bring. Plant closings, audit disclosures, and the strategic misrepresentation of facts are among the dilemmas examined in these end-of-chapter dilemmas.

- Twenty-four cases, most new, cover breaking news topics, with special attention to corporate scandals, Sarbanes-Oxley legislation, and corporate reactions.
- New PowerPoint slides and revised chapter outlines accompany the materials for text adopters.
- Updated ethical insight features and end-of-chapter questions and exercises are designed to motivate the reader's active participation in chapter topics.
- Boxed inserts throughout the chapters illustrate current applications of chapter content in a business context. Integrating ethical frameworks with current events provides numerous opportunities to set up problems and deliver the tools to effect solutions at the same time. Businesses face difficult problems every day, and the media ceaselessly report on those problems. *Business Ethics* draws on this vast reservoir to make its points accessible, credible, and relevant.

This edition also expands stakeholder analysis to incorporate a values-driven management approach. For example, Chapter 6, which addresses internal stakeholders, investigates options for assessing an organization's readiness to manage from a values-driven and stakeholder-responsiveness approach.

## A PROACTIVE APPROACH

Although business ethics issues change daily, classic ethical principles remain constant. The challenge in writing this book was to devise an effective vehicle that integrates the two. This book presents contemporary and classic business cases and decisions that can be analyzed and interpreted using ethical principles and decision-making negotiation styles. "Hypernorms" and conflict resolution techniques are illustrated along with classic ethical principles.

As earlier editions of this book demonstrated, *Business Ethics* encourages the reader to take on the decision maker's role. With thought-provoking cases and discussion questions that ask, "What would you do if you had to decide a course of action?" *Business Ethics* also encourages readers to articulate and share their decision-making rationales and strategies. Readers will also be able to examine changing ethical issues and business problems with a critical eye. We take a close look at the business reporting of the *Wall Street Journal*, *60 Minutes*, *20/20*, the *New York Times*, *BusinessWeek*, the *Economist*, and other online and off-line sources to learn from the challenges, practices, and mistakes of companies and organizations around the world.

## STAKEHOLDER AND ISSUES MANAGEMENT ANALYSIS

Stakeholder analysis is one of the most comprehensive orienting approaches for identifying issues, groups, strategies, and outcomes (potential or realized) revolving around complex ethical dilemmas. Stakeholder, issues management, and ethical methods can be used throughout the book. These

methods are presented in an updated and more integrative Chapter 2. This chapter offers a useful starting point for mapping the who, what, when, where, why, and how of ethical problems involving organizations and their constituencies. Issues and crisis management frameworks are explained and integrated into approaches that complement the stakeholder analysis. Several other ethical problem-solving frameworks, quick tests, and negotiation techniques are presented in Chapters 3 and 8.

## FEATURES OF THE BOOK

- Clear and understandable presentations. Principles, concepts, and examples are written to minimize jargon and maximize meaning. Although intended primarily for the dedicated course in business ethics, this text may also serve as a useful adjunct in other course areas, namely, introduction to business, business law, business and society, and business policy.
- Additional contemporary cases. *Business Ethics* retains and updates many of its longer cases, adding fifteen new, shorter cases to the mix. The cases are grouped at the end of appropriate chapters.
- Global scope. Ethics, advantageously integrated into the world economy, forms the core of Chapter 8, “Business Ethics, Stakeholder Management, and Multinational Corporations in the Global Environment.”
- Contemporary approach. Revised sections on globalization, international ethics, stakeholder management and negotiation methods for assessing organizations, and ways business ethics has been affected since the corporate scandals, including the subprime lending crisis and the advance of the new emerging economies in the global economy. Contemporary individual and professional ethical dilemmas in business are presented throughout the text.
- Cross-disciplinary reach. Topics relating to philosophy, law, ethics, business and society, and management increase understanding.

## OBJECTIVES OF THE BOOK

- To introduce and motivate students about basic ethical concepts, principles, and examples while enhancing their understanding and use of ethics in solving moral dilemmas that are occurring now at every professional level.
- To introduce in a simple, straightforward, and interesting way stakeholder and issues management methods as strategic and practical ways for mapping corporate, group, and individual relationships so readers can understand and apply ethical reasoning in the marketplace and in workplace relationships.
- To engage and expand readers’ awareness of what constitutes ethical and unethical practices in business at the individual, group, organizational, global, and multinational levels through real-time—not hypothetical—ethical dilemmas, stories, and cases.
- To instill self-confidence and competence in the readers’ ability to think and act according to moral principles as they create, manage, and

study stakeholder relationships in their own worlds at the national and international level.

## STRUCTURE OF THE BOOK

- Chapter 1 defines business ethics and familiarizes the reader with examples of ethics in business practices, levels of ethical analysis, and what can be expected from a course in business ethics.
- Chapter 2 introduces the stakeholder and issues management methods for studying social responsibility relationships at the individual employee, group, and organizational levels. These methods provide and encourage the incorporation of ethical principles and concepts from the entire book.
- Chapter 3 engages students in a discussion of the “micro-level” approach to ethical decision making. Moral principles and concepts derived from both classic and more contemporary ways of thinking and acting ethically are presented. Individual styles of moral decision making are also discussed in this section. Although this section is a micro-level approach, these principles can be used to examine and explain corporate strategies and actions as well. (Executives, managers, employees, coalitions, government officials, and other external stakeholder groups are treated as individuals.)
- Chapter 4 presents ethical issues and problems that firms face with external consumers, government, and environmental groups. The question, “How moral can and should corporations be and act in commercial dealings?” is examined. Do corporations have a conscience? Classic and recent crises resulting from corporate and environmental problems are covered.
- Chapter 5 explains ethical problems that consumers face in the marketplace: product safety and liability, advertising, privacy, the Internet. The questions, “How free is ‘free speech’? How much are you willing to pay for safety? Who owns the environment? Who regulates the regulators in an open society?” are asked and addressed.
- Chapter 6 presents the corporation as internal stakeholder and discusses leadership, strategy, structure, alliances, culture, and systems as dominant themes regarding how to lead, manage, and be a responsible follower in organizations today.
- Chapter 7 addresses the individual employee stakeholder and examines new and changing workforce/workplace trends, moral issues, and dilemmas employees and managers face and must solve to survive and compete in national and global economies.
- Chapter 8 extends the level of analysis to global and multinational corporations (MNCs) and discusses ethical issues between MNCs, host countries, and other groups. Competencies of new entrants into the global workforce are introduced in this edition. Issues resulting from globalization are presented along with stakeholders who monitor corporate responsibility internationally. Negotiation techniques for professionals responsibly doing business abroad are presented.

## TEACHING AND LEARNING TOOLS, WEB SITE, VIDEOS, SUPPLEMENTS

The following ancillaries are available to instructors who adopt *Business Ethics: A Stakeholder and Issues Management Approach*:

- Instructor's Manual and Test Bank is available online at <http://www.cengage.com/management/weiss> and with the Instructor's Resources CD (0-324-59790-8). The Instructor's Manual and Test Bank includes lecture outlines, suggested answers to end-of-chapter discussion questions and ethical dilemmas, case notes, and test questions. The Instructor's Manual and Test Bank was written by Ross Mechem, Virginia Polytechnic Institute and State University.
- PowerPoint. Lecture-support slides. Prepared by Christina Stamper, Western Michigan University. Available for download at <http://www.cengage.com/management/weiss>.
- ExamView Testing Software. Contains all the questions available in the online Test Bank. ExamView is an easy-to-use test-creation program available in Windows and Macintosh formats. Available on the Instructor's Resource CD (0-324-59790-8).
- Instructor's Resource CD (0-324-59790-8). Includes key instructor ancillaries (instructor's manual, Test Bank, ExamView, and PowerPoint slides) on CD-ROM, giving instructors the ultimate tool for customizing lectures and presentations.
- Video (DVD 0-324-59702-9). *ABC News* and Cengage Learning have joined forces again to provide a collection of videos relevant to specific segments of the book. The video selections support the themes of the book and deepen students' understanding of the ethical concepts presented throughout the text. Some of today's most compelling issues—Gas Prices vs. Petroleum Company High Profit Margins, GAP and Child Labor issues, India Rising, Richard Branson and his commitment to bio-fuel alternatives—have been covered by the news and selected for this DVD.
- Web Site (<http://www.cengage.com/management/weiss>). Offers a host of ancillary materials for students and instructors, including downloadable ancillaries for the instructor, such as additional cases, PowerPoint Lectures, and Instructor's Manual and Test Bank.

## CASES

Twenty-four cases are included in this edition, fourteen of which are new and three thoroughly updated:

### Chapter 1

- Enron: What Caused the Ethical Collapse? (updated)
- Microsoft: The Next Chapter (updated)

### Chapter 2

- Mattel Toy Recalls (new)
- JetBlue: Bringing Humanity Back to Air Travel? (new)

- Arthur Andersen: Shredding the Reputation and Viability of a Once Venerable Accounting Firm (updated)

**Chapter 3**

- Samuel Waksal and ImClone
- Aaron Feuerstein and Malden Mills: How Values Guide Actions in a Post-Crisis Situation
- Jerome Kerviel: Rogue Trader or Misguided Employee: What Really Happened at the French Bank, Société Générale? (new)
- Seeking Two Kinds of Green: Richard Branson's Venture into Biofuels (new)
- Ford's Pinto Fires: The Retrospective View of Ford's Field Recall Coordinator

**Chapter 4**

- Reinventing Napster: How Many Lives for the Cat with Headphones? (updated)
- VIOXX, Dodge Ball: Did Merck Try to Avoid the Truth? (new)
- "Who Killed the Electric Car?" (new)
- Skype and Peer-to-Peer VoIP Technology: Too Good to Be True? (new)

**Chapter 5**

- Facebook's Beacon: Marketer's Treasure or User's Nightmare? (new)
- Genetic Discrimination (new)

**Chapter 6**

- Commitments to Sustainability in the Oil and Gas Industry: Do the Actions Match the Words? (new)
- What's Written versus What's Reality: Ethical Dilemmas in a Hi-Tech Public Relations Firm

**Chapter 7**

- Wal-Mart: Ongoing Challenges with Gender Discrimination (new)
- Don't Ask, Don't Tell: A Policy on Gays in the Military (new)
- Women on Wall Street: Fighting for Equality in a Male-Dominated Industry

**Chapter 8**

- China, India, and Wal-Mart: Issues of Price, Quality, and Sourcing (new)
- Google Goes to China (new)
- Sweatshops: Are Companies Willing to Solve the Problem? (new)

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I am always open to your suggestions and ideas to improve this text. Please send the editors and me your thoughts and feedback. We will strive to incorporate your recommendations as we have in past editions.

Joseph W. Weiss  
Bentley College



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# Case Authorship

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## **CASE 2 Microsoft: The Next Chapter 32**

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## **CASE 3 Mattel Toy Recalls 79**

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## **CASE 4 JetBlue: Bringing Humanity Back to Air Travel? 84**

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## **CASE 5 Arthur Andersen: Shredding the Reputation and Viability of a Once Venerable Accounting Firm 88**

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**CASE 9 Seeking Two Kinds of Green: Richard Branson's Venture into Biofuel 143**

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**CASE 10 Ford's Pinto Fires: The Retrospective View of Ford's Field Recall Coordinator 146**

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**CASE 11 Reinventing Napster: How Many Lives for the Cat with Headphones? 192**

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## **CASE 16 Genetic Discrimination 265**

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## **CASE 17 Commitments to Sustainability in the Oil and Gas Industry: Do the Actions Match the Words? 325**

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## **CASE 20 Don't Ask, Don't Tell: A Policy on Gays in the Military 398**

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# 1

## BUSINESS ETHICS, THE CHANGING ENVIRONMENT, AND STAKEHOLDER MANAGEMENT

### 1.1 Business Ethics and the Changing Environment

### 1.2 What Is Business Ethics? Why Does It Matter?

### 1.3 Levels of Business Ethics

Ethical Insight 1.1

### 1.4 Five Myths about Business Ethics

### 1.5 Why Use Ethical Reasoning in Business?

### 1.6 Can Business Ethics Be Taught and Trained?

### 1.7 Plan of the Book

#### Chapter Summary

#### End-of-Chapter Questions and Exercises

#### Real-Time Ethical Dilemma

#### Cases

Enron: What Caused the Ethical Collapse?

Microsoft: The Next Chapter

## OPENING CASE

Blogger: "Hi. i download music and movies, limewire and torrent. is it illegal for me to download or is it just illegal for the person uploading it. does anyone know someone who was caught and got into trouble for it, what happened them. Personally I dont see a difference between downloading a song or taping it on a cassette from a radio!!"<sup>1</sup>

The Recording Industry Association of America (RIAA), on behalf of its member companies, has sued more than 20,000 people for unlawful downloading. RIAA detectives easily learn of the illegal downloading activity by logging on to peer-to-peer networks such as Kazaa, where users' sharefolders

are visible to all. The majority of these cases have been settled out of court for one to three thousand dollars. Still, the RIAA continues to protect the rights of copyright owners, deterring illegal file sharing by issuing lawsuits against individuals and universities.

Students often use university networks to illegally distribute copyrighted sound recordings on unauthorized peer-to-peer services. The RIAA issues subpoenas to universities nationwide. Most conform and give the identity of students only after assisting those accused by providing an opportunity to stop the subpoena with their own funds. The university networks used for this illegal activity

include schools in Connecticut, Georgia, Kansas, Michigan, Minnesota, New Jersey, Pennsylvania, Rhode Island, Texas, Virginia, and Washington. As in earlier rounds of lawsuits, the RIAA is utilizing the “John Doe” litigation process, which is used to sue defendants whose names are not known.

Citing the ongoing effort to reach out to the university community on proactive solutions to the problem of illegal file sharing on college campuses, Cary Sherman, the RIAA’s president, said:

It remains as important as ever that we continue to work with the university community in a way that is respectful of the law as well as university values. That is one of our top priorities, and we believe our constructive outreach has been enormously productive so far. Along with offering students legitimate music services, campus-wide educational and technological initiatives are playing a critical role. But there is also a complementary need for enforcement by copyright owners against the serious offenders—to remind people that this activity is illegal.

Sherman stated:

Illegally downloading music from the Internet costs everyone—the musicians not getting compensated for their craft, the owners and employees of the thousands of record stores that have been forced to close, legitimate online music services building their businesses, and consumers who play by the rules and purchase their music legally.

In 2007, a ruling was handed down to Christopher David Brennan of Waterford, Conn., by plaintiffs Atlantic Recording, Electra Entertainment Group, Interscope Records, Sony BMG Music Entertainment, and BMG Music. These record companies claimed that Brennan violated their copyrights by storing 2,071 songs on his PC, “including Hootie and the Blowfish’s ‘Drowning’ and Billy Joel’s ‘Don’t Ask Me Why.’” Court records show that Brennan’s mother

was served a notice that he needed to appear in court, but he never showed up. So the record labels asked for a default judgment, which would have meant Brennan would have to pay the labels for each infringing file, among other remedies. The companies alleged that Brennan “used an ‘online media distribution system’ to ‘make available’ copyrighted recordings.”

On February 13, 2008, U.S. District Judge Janet Bond Arterton denied granting a default judgment, writing that “the record labels failed to show Brennan was actually distributing copies of songs, which he said is what is against the law,” and that the companies’ “allegations of infringement lack any factual grounding whatsoever.” Pamela Jones, writing on the Groklaw blog, noted that, “Arterton essentially rejected that having songs present on a PC constitutes a violation of copyright ... That seems to be a very significant blow to the RIAA’s template litigation strategy,” she wrote. Recording companies now hire computer forensics companies to locate and track file-sharing networks to file sharers. The IP address for a computer connected to a file-sharing network is found and given to the recording companies, who then try to force ISPs to identify the subscriber connected with the address.

Privacy activists argue, in turn, that a person’s IP address (which identifies the subscriber but not necessarily the person) is private, protected information that can be shown during criminal but not civil investigations. Fred von Lohmann, senior staff attorney with the Electronic Frontier Foundation, stated on his organization’s blog that Arterton’s recent ruling “suggests that courts are not prepared to simply award default judgments worth tens of thousands of dollars against individuals based on a piece of paper backed by no evidence.”<sup>2</sup>

## 1.1 BUSINESS ETHICS AND THE CHANGING ENVIRONMENT

Businesses and governments operate in changing technological, legal, economic, social, and political environments with competing stakeholders and power claims. As the opening story shows, there is more than one side to every complex issue and debate involving businesses, consumers, families, other institutions, and professionals. When stakeholders and companies cannot agree or negotiate competing claims among themselves, the issues generally go to the courts. The RIAA, in the opening case, does not wish to alienate too many college students because they are also the music industry's best customers. At the same time, the association believes it must protect those groups it represents. Also, not all stakeholders in this controversy agree on goals and strategies. For example, not all music artists oppose students downloading or even sharing some of their copyrighted songs. Offering free access to some songs is a good advertising tactic. On the other hand, shouldn't those songwriters and recording companies who spend their time and money creating, marketing, distributing, and selling their intellectual property protect that property? Is file sharing, without limits or boundaries, stealing other people's property? If not, what is this practice to be called? On the other hand, if file sharing continues in some type of form, and if it does help sell large numbers of labels for many artists, will this "practice" become legitimate? While the debate continues, individuals (15 years old and younger in many cases) who illegally share files also have rights as private citizens under the law, and recording companies have rights of property protection. Who is right and who is wrong, especially when two rights collide? Who stands to lose and gain from this case? Who gets hurt by these transactions? Which group's ethical positions are most defensible?

*Stakeholders* are individuals, companies, groups, and even nations that cause and respond to external issues, opportunities, and threats. Corporate scandals, globalization, deregulation, mergers, technology, and global terrorism have accelerated the rate of change and the uncertainty in which stakeholders must make business and moral decisions. Issues concerning questionable ethical and illegal business practices confront everyone, as the following examples illustrate:

- The subprime lending crisis is one of the latest business scandals. Consumers, banks, mortgage companies, real estate firms, home owners, and a host of other stakeholders were involved. Many of those who were sold mortgages were lied to about low-risk, high-return products. "On January 17th, Merrill Lynch announced its largest loss ever—\$9.8 billion for the fourth quarter of 2007. This came as a result of a write down of the value of certain assets held by the company—a \$16.7 billion loss in book value. The assets had been purchased as part of the subprime mortgage bonanza of a few years ago." This crisis is contributing to the entire U.S. economy's tilting to the brink of recession.<sup>3</sup> Another corporate scandal—this time it's worse!
- The corporate scandals at Enron, Adelphia, Halliburton, MCI WorldCom, Tyco, Arthur Andersen, Global Crossing, Dynergy, Qwest, Merrill Lynch, and other firms jarred shareholder and public confidence in Wall Street



and corporate governance. “Only 18% of Americans express a great deal or quite a lot of confidence in big business, compared to 59% who express confidence in small business. Confidence in big business has never been high, reaching its maximum of 34% in 1974. Even in the halcyon days of the dot.com boom in the late 1990s, only 30% of Americans expressed a great deal or quite a lot of confidence in big business. The current 18% confidence rating in big business is the same as last year, and remains the lowest in Gallup history.”<sup>4</sup>

- The debate continues over excessive pay to those chief executive officers (CEOs) who posted poor corporate performance. “Shareholders want CEOs to be paid for their long-term performance,” said AFSCME (American Federation of State, County and Municipal Employees) President Gerald W. McEntee. AFSCME’s 1.4 million members participate in public pension funds with combined assets worth more than \$1 trillion. “We are in the middle of a sub-prime mortgage crisis where some failing CEOs are walking away with hundreds of millions of dollars. That makes no sense, and we think giving shareholders a vote on CEO pay will help to stop it.” In early 2008 investors filed shareholder resolutions at more than 90 companies “where pay has been excessive or where there has been a perceived misalignment between pay and performance over the past three to five years, including Abbott Laboratories, Bear Stearns, Blockbuster, Capital One, Citigroup, Coca-Cola, Countrywide Financial, Lexmark, Merrill Lynch, Morgan Stanley, Motorola, Northrop Grumman, and Wells Fargo.”<sup>5</sup>
- Are companies becoming overregulated since the scandals? The Sarbanes-Oxley Act of 2002 is one response to the corporate scandals. This act states that corporate officers will serve prison time and pay large fines if they are found guilty of fraudulent financial reporting and of deceiving shareholders. Implementing this legislation requires companies to create accounting oversight boards, establish ethics codes, and show financial reports in greater detail to investors. Implementing these provisions is costly for corporations. Some claim their profits and global competitiveness are negatively affected and the regulations are “unenforceable.”<sup>6</sup>
- U.S. firms are outsourcing work to India and other countries to cut costs and improve profits. Estimates of U.S. jobs outsourced range from 104,000 in 2000 to 400,000 in 2004, and to a projected 3.3 million by 2015. Do U.S. employees who are laid off and displaced need protection, or is this practice part of another societal business transformation? Is the United States becoming part of a global supply chain in which outsourcing is “business as usual” in a “flat world,” or is the working middle class in the United States and elsewhere at risk to predatory industrial practices and ineffective government policies?<sup>7</sup>

These are a sample of larger macrolevel issues that occur among stakeholders in rapidly changing business environments. Add the ongoing issues resulting from disruptive technologies and increased working hours on professional and personal stress levels, and you can see the pressures created on stakeholders. Large issues, like the open-file-sharing story, can become personal quickly, depending on who is involved and who is at risk. Before discussing

stakeholder management, we take a brief look at the broader environmental forces that affect industries, organizations, and individuals.

## Seeing the “Big Picture”

Pulitzer Prize-winning journalist Thomas Friedman, author of *The World Is Flat 3.0*, has also written a vivid account of the accelerating trend toward globalization in *The Lexus and the Olive Tree*.<sup>8</sup> A macro-environmental perspective provides a first step using stakeholder and issues approaches to map out and analyze interactions between organizations and groups. Friedman notes:

Like everyone else trying to adjust to this new globalization system and bring it into focus, I had to retrain myself and develop new lenses to see it. Today, more than ever, the traditional boundaries between politics, culture, technology, finance, national security, and ecology are disappearing. You often cannot explain one without referring to the others, and you cannot explain the whole without reference to them all. I wish I could say I understood all this when I began my career, but I didn't. I came to this approach entirely by accident, as successive changes in my career kept forcing me to add one more lens on top of another, just to survive. (pp. 2, 20)

Quoting Murray Gell-Mann, the Nobel laureate and former professor of theoretical physics at Caltech, Friedman continues:

We need a corpus of people who consider that it is important to take a serious and professional look at the whole system. It has to be a crude look, because you will never master every part or every interconnection. Unfortunately, in a great many places in our society, including academia and most bureaucracies, prestige accrues principally to those who study carefully some [narrow] aspect of a problem, a trade, a technology, or a culture, while discussion of the big picture is relegated to cocktail party conversation. That is crazy. We have to learn not only to have specialists but also people whose specialty is to spot the strong interactions and entanglements of the different dimensions, and then take a crude look at the whole. (p. 28)

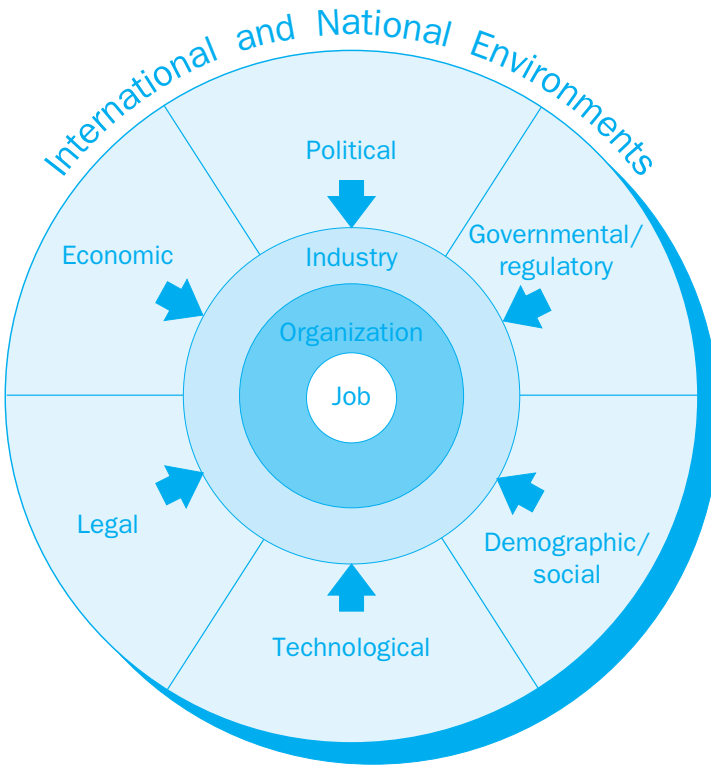
## Environmental Forces and Stakeholders

Organizations are embedded in and interact with multiple changing local, national, and international environments, as the previous excerpts illustrate. These environments are increasingly merging into a global system of dynamically interrelated interactions among businesses and economies. We must “think globally before acting locally” in many situations. The macrolevel environmental forces shown in Figure 1.1 affect the performance and operation of industries, organizations, and jobs. This framework can be used as a starting point to identify trends, issues, opportunities, and ethical problems that affect people and stakes in different levels. A first step toward understanding stakeholder issues is to gain an understanding of environmental forces that influence stakes. As we discuss an overview of these environmental forces here, think of the effects and pressures each of the forces has on you.

*The economic environment* continues to evolve into a more global context of trade, markets, and resource flows. Large and small U.S. companies are expanding businesses and products overseas. Stock and bond market volatility and interdependencies across international regions are unprecedented. The European market has consolidated currencies in order to facilitate

Figure 1.1

### Environmental Dimensions Affecting Industries, Organizations, and Jobs



competitiveness and monetary flow. The rise of China and India as the next superpowers presents new trade opportunities and business practices. Do you see your career and next job being affected by this round of globalization?

*The technological environment* has ushered in the advent of electronic communication, social online networking, and the Internet, all of which are changing economies, industries, companies, and jobs. U.S. jobs that are based on routine technologies and rules-oriented procedures are vulnerable to outsourcing. Online technologies facilitate changing corporate “best practices.” Company supply chains are also becoming virtually and globally integrated online. While speed, scope, economy of scale, and efficiency are transforming transactions through information technology, privacy and surveillance issues continue to emerge. The boundary between surveillance and convenience also continues to blur. Has the company or organization for which you work used surveillance to monitor Internet use?

Electronic democracy is changing the way individuals and groups think and act on political issues. Instant Web surveys, which are broadcast over CNN and interactive Web sites, have created a global chatroom for political issues. Creation of online communities in the 2004 and 2008 campaigns have proved an effective political strategy for both U.S. parties’ fund-raising

programs and mobilizing of new voters. Have you used the Internet to participate in a national, local, or regional political process?

*The government and legal environment* continues to issue regulatory laws and procedures to protect consumers and restrict unfair corporate practices. Since Enron and other corporate scandals, the Sarbanes-Oxley Act of 2002 and the revised 2004 Federal Sentencing Guidelines were created to audit and constrain corporate executives from blatant fraudulence on financial statements. Several federal agencies are also changing—or ignoring—standards for corporations. The U.S. Food and Drug Administration (FDA), for example, speeds up the required market approval time for new drugs sought by patients with life-threatening diseases, but lags behind in taking some unsafe drugs off the market.

Uneven regulation of fraudulent and anticompetitive practices affects competition, shareholders, and consumers. Executives from Enron and other large U.S. firms involved in scandals have been tried and sentenced. Should the banks that loaned funds to these also be charged with wrongdoing? Should U.S. laws be enforced more evenly? Who regulates the regulators? The subprime lending crisis raises some of the same questions. Who can the public trust for advice about mortgages and substantial loans? Who is responsible and accountable for educating and constraining the public in such transactions in a democratic, capitalist society?

*Legal* questions and issues affect all of these environmental dimensions and every stakeholder and investor. How much power should the government have to administer laws to protect citizens and ensure that business transactions are fair? Also, who protects the consumer in a free market system? These issues, which are exemplified in the file-sharing controversy as summarized in the opening story, question the nature and limits of consumer and corporate laws in a free market economy.

*The demographic and social environment* continues to change as national boundaries experience the effects of globalization and the workforce becomes more diverse. Employers and employees are faced with aging populations, minorities becoming majorities, generational differences, and the effects of downsizing and outsourcing on morale productivity, and security. How can companies effectively integrate a workforce that is increasingly both younger and older, less educated and more educated, and technologically sophisticated and technologically unskilled?

These environmental factors are incorporated into a stakeholder and issues management approach that also includes an ethical analysis of actors external and internal to organizations. A larger perspective underlying these analytical approaches is the question: How can the common good of all stakeholders in controversial situations be realized?

## Stakeholder Management Approach

How do companies, the media, political groups, consumers, employees, competitors, and other groups respond when they are affected by an issue, dilemma, threat, or opportunity from the environments just described? The stakeholder management approach is a way of understanding the ethical effects of environmental forces and groups on specific issues that affect real-time stakeholders and their welfare.

Figure 1.2

## Primary vs. Secondary Stakeholder Group



The stakeholder approach begins to address these questions by enabling individuals and groups to articulate collaborative, win-win strategies based on:

1. Identifying and prioritizing issues, threats, or opportunities
2. Mapping who the stakeholders are
3. Identifying their stakes, interests, and power sources
4. Showing who the members of coalitions are or may become
5. Showing what each stakeholder's ethics are (and should be)
6. Developing collaborative strategies and dialogue from a "higher ground" perspective to move plans and interactions to the desired closure for all parties

Chapter 2 lays out specific steps and strategies for analyzing stakeholders. Here, our aim is to develop awareness of the ethics and social responsibilities of different stakeholders. As Figure 1.2 illustrates, there can be a wide range of stakeholders in any situation. We turn to a general discussion of "business ethics" in the following section to introduce the subject and motivate you to investigate ethical dimensions of organizational and professional behavior.

## 1.2 WHAT IS BUSINESS ETHICS? WHY DOES IT MATTER?

Business ethicists ask, "What is right and wrong, good and bad, harmful and beneficial regarding decisions and actions in organizational transactions?" Ethical "solutions" to business and organizational problems may have more than one alternative, and sometimes no right solution may seem available.

Learning to think, reason, and act ethically can enable us to first be aware of and recognize a potential ethical problem. Then we can evaluate values, assumptions, and judgments regarding the problem before we act. Ultimately, ethical principles alone cannot answer what the noted theologian Paul Tillich called “the courage to be” in serious ethical dilemmas or crises. We can also learn from business case studies, role playing, and discussions how our actions affect others in different situations. Acting accountably and responsibly is still a choice.

Laura Nash defined business ethics as “the study of how personal moral norms apply to the activities and goals of commercial enterprise. It is not a separate moral standard, but the study of how the business context poses its own unique problems for the moral person who acts as an agent of this system.” Nash stated that business ethics deals with three basic areas of managerial decision making: (1) choices about what the laws should be and whether to follow them; (2) choices about economic and social issues outside the domain of law; and (3) choices about the priority of self-interest over the company’s interests.<sup>9</sup>

## Unethical Business Practices and Employees

The fifth (2007) National Business Ethics Survey (NBES) that obtained 1,929 responses representative of the entire U.S. workforce<sup>10</sup> found that “the ethics risk landscape is as treacherous in business as it was before implementation of the Sarbanes-Oxley Act of 2002.” The survey findings are summarized in the “good” and “bad” news found in the workforce:

### The “Bad” News

- Ethical misconduct in general is very high and back at pre-Enron levels. Many employees do not report what they observe—they are fearful about retaliation and skeptical that their reporting will make a difference. One in eight employees experiences some form of retaliation for reporting misconduct.
- The number of companies that are successful in incorporating a strong enterprise-wide ethical culture into their business has declined since 2005. Only 9% of companies have strong ethical cultures.

### The “Good” News

- The number of formal ethics and compliance programs is on the rise. In companies with well-implemented programs, there is increased reporting, reducing ethics risk.
- The survey has been able to show definitively that companies that move beyond a singular commitment to complying with laws and regulations and adopt an enterprise-wide ethical culture dramatically reduce misconduct.

Authors of the survey note that, “what seems to matter most is the extent to which leaders intentionally make ethics a part of their daily conversations and decision-making, supervisors emphasize integrity when working with their direct reports, and peers encourage each other to act ethically.”<sup>11</sup>

### Specific Types of Ethical Misconduct Reported

- In the past 12 months, more than half (56%) of employees personally observed conduct that violated company ethics standards, policy, or the law;
- Conflicts of interest: putting one's own interests above the organization (observed by 23% of employees);
- Abusive or intimidating behavior (observed by 21% of employees);
- Lying to employees (observed by 20% of employees).<sup>12</sup>

Despite an uptick in reporting in 2003 and a slight increase in 2007, many employees still do not report misconduct that they observe. More than two in five employees who saw misconduct did not report it. More than one-third who saw misconduct chose to resolve the issue themselves rather than report through official company channels. Two in five of these employees did not report because they would have had to report the misconduct to the person involved, and one in four were not aware of any mechanism to report anonymously.<sup>13</sup>

### Ethics and Compliance Programs

Only one in four companies has a well-implemented ethics and compliance program. Only 25% of employees:

- are willing to seek advice about ethics questions that arise;
- feel they are prepared to handle situations that could lead to misconduct;
- indicate that they are rewarded for ethical behavior;
- report that their company does not reward success obtained through questionable means;
- say they feel positively about their company.<sup>14</sup>

**The Retaliation Trust/Fear/Reality Disconnect** Eighty percent believe that management does not tolerate retaliation; however, 36% of those who didn't report feared retaliation and only 12% of those who did report experienced retaliation.<sup>15</sup>

Reporting rates are almost double in companies that have well-implemented ethics *and* compliance programs; 66% of employees whose companies have well-implemented ethics and compliance programs report observed misconduct, compared with only 35% of employees whose companies have little or no ethics and compliance.

It is interesting to note the differences in the size of an organization and employees' perceptions of business ethics. Evidently, from the findings of the National Business Ethics Survey, size matters:

- Risks associated with abusive behavior and lying to employees increases with the number of employees: small companies include 2–99 employees in the survey; large companies include 100,000 or more employees.
- Publicly traded companies are at higher ethics risk than privately held and smallest companies for 14 of the 18 specific types of misconduct, despite the fact that the firms may have a comprehensive ethics compliance program.<sup>16</sup>

These findings suggest that any useful definition of business ethics must address a range of problems in the workplace, including relationships among professionals at all levels and among corporate executives and external groups.

## Why Does Ethics Matter in Business?

**Financially and Economically** “Doing the right thing” matters to firms, taxpayers, employees, and other stakeholders, as well as to society. To companies and employers, acting legally and ethically means saving billions of dollars each year in lawsuits, settlements, and theft. One study found that the annual business costs of internal fraud range between the annual GDP of Bulgaria (\$50 billion) and that of Taiwan (\$400 billion). It has also been estimated that theft costs companies \$600 billion annually, and that 79% of workers admit to or think about stealing from their employers. Other studies have shown that corporations have paid significant financial penalties for acting unethically.<sup>17</sup> Also, CNN reported that an estimated one out of three businesses close because of employee theft. The so-called cheating culture creates an environment that discourages whistle-blowers from stepping up and telling what they know.<sup>18</sup>

**Relationships, Reputation, Morale, and Productivity** Costs to businesses also include deterioration of relationships; damage to reputation; declining employee productivity, creativity, and loyalty; ineffective information flow throughout the organization; and absenteeism. Companies that have a reputation of unethical and uncaring behavior toward employees also have a difficult time recruiting and retaining valued professionals.

**Integrity, Culture, Communication, and the Common Good** For business leaders and managers, managing ethically also means managing with integrity.<sup>19</sup> A study of the 50 best companies to work for in Canada (based on survey responses from over 100,000 Canadian employees at 115 organizations, with input from 1,400 leaders and human resources professionals) found that integrity and ethics matter in the following ways: there is more flexibility and balance; values have changed; and organizations are valuing new employees more since the demographics have changed. These changes are explained next.

**Integrity/Ethics** What is the degree to which co-workers, managers, and senior leaders display integrity and ethical conduct? Eighty-eight percent of employees at the top 10 best employers agreed or strongly agreed that co-workers displayed integrity and ethical conduct at all times, whereas only 60% felt that way at the bottom 10 organizations. With respect to managers, the numbers were 90% at the top 10 and 63% at the bottom 10 organizations. A bigger difference existed with regard to whether senior leadership displayed integrity and ethical conduct at all times, with 89% of employees at the top 10 best employers agreeing or strongly agreeing while less than half—48%—felt that way at the bottom 10 employers.<sup>20</sup>

The same study also found that “engagement is higher at organizations where employees feel they share the same values as their employer.” Also, “That sense of ‘common purpose’ can increase employee commitment, especially amongst older workers... On the other hand, a perceived lack of integrity on the part of co-workers, managers and leaders has, as expected, a detrimental effect on engagement. What was perhaps unanticipated in the



study findings, however, was the really negative opinion of the ethics of senior leadership at low-engagement organizations.”

## Working for the Best Companies

Employees care about ethics because they are attracted to ethically and socially responsible companies. *Fortune* magazine regularly publishes the 100 best companies for which to work (<http://www.fortune.com>).<sup>21</sup> Although the list continues to change, it is instructive to observe some of the characteristics of good employers that employees repeatedly cite. The most frequently mentioned characteristics include profit sharing, bonuses, and monetary awards. However, the list also contains policies and benefits that balance work and personal life and those that encourage social responsibility. Consider these policies described by employees:

- When it comes to flextime requests, managers are encouraged to “do what is right and human”
- An employee hotline to report violations of company values
- Will fire clients who don’t respect its security officers
- Employees donated more than 28,000 hours of volunteer labor last year

The public and consumers benefit from organizations acting in an ethically and socially responsible manner. Ethics matters in business because all stakeholders stand to gain when organizations, groups, and individuals seek to do the right thing, as well as to do things the right way. Ethical companies create investor loyalty, customer satisfaction, and business performance and profits.<sup>22</sup> The following section presents different levels on which ethical issues can occur.

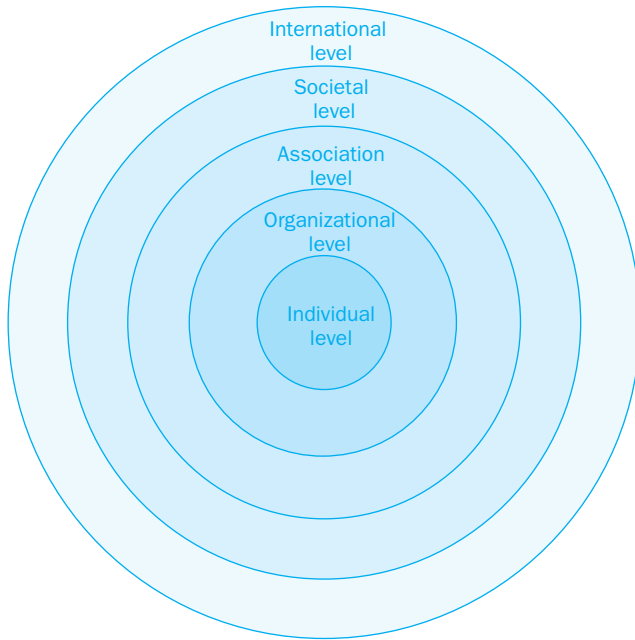
## 1.3 LEVELS OF BUSINESS ETHICS

Because ethical problems are not only an individual or personal matter, it is helpful to see the different levels at which issues originate, and how they often move to other levels. Because business leaders and professionals must manage a wide range of stakeholders inside and outside their organizations, understanding the issues that stakeholders face facilitates our understanding of the complex relationships between participants involved in solving ethical problems.

Ethical and moral issues in business can be examined from at least five levels. Figure 1.3 on the next page illustrates these five levels: individual, organizational, association, societal, and international.<sup>23</sup> Aaron Feuerstein’s story as former CEO of Malden Mills exemplifies how an ethical leader in his seventies turned a disaster into an opportunity. His story also shows how his actions reflect his person, faith, allegiance to his family and community, and sense of social responsibility, which made an impact beyond the nation.

On December 11, 1995, Malden Mills in Lawrence, Massachusetts—manufacturer of Polartec and Polarfleece fabrics and the largest employer in the city—was destroyed by fire. Over 1,400 people were out of work.

Figure 1.3

**Business Ethics Levels**

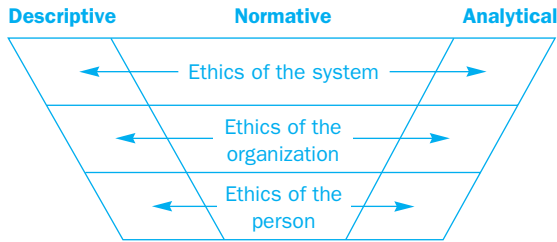
**SOURCE:** Archie B. Carroll. (1978). Linking business ethics to behavior in organizations. *SAM Advanced Management Journal*, 43(3). 7. Reprinted with permission from Society for Advancement of Management, Texas A&M University, College of Business, 6300 Ocean Drive, FC111, Corpus Christi, Texas, 78412.

Feuerstein stated, “Everything I did after the fire was in keeping with the ethical standards I’ve tried to maintain my entire life, so it’s surprising we’ve gotten so much attention. Whether I deserve it or not, I guess I became a symbol of what the average worker would like corporate America to be in a time when the American dream has been pretty badly injured.” Feuerstein announced shortly after the fire that the employees would stay on the payroll, while the plant was rebuilt, for 60 days. He noted, “I think it was a wise business decision, but that isn’t why I did it. I did it because it was the right thing to do.” Mrs. Feuerstein personally signed off on all the rebuilding plans and ran a division of Malden Mills.

Feuerstein could have taken the \$300 million in insurance and retired, or even offshored the entire operation. Instead, he paid out \$25 million and helped rebuild the plant. Feuerstein spent the insurance funds, borrowed \$100 million more, and built a new plant that is both environmentally and worker friendly. It is also unionized. Feuerstein commented, “You are not permitted to oppress the working man, because he’s poor and he’s needy, amongst your brethren and amongst the non-Jew in your community.” Feuerstein was invited to President Clinton’s State of the Union address and serves as an icon in the business ethics and leadership community, regardless of the fate of Malden Mills going forward.<sup>24</sup>

Figure 1.4

### A Framework for Classifying Ethical Levels



**SOURCE:** John B. Matthews, Kenneth E. Goodpaster, Laura L. Nash. (1985). *Policies and Persons: A Casebook in Business Ethics*, p. 509. New York: McGraw-Hill. Reproduced with permission of the McGraw-Hill Companies.

### Asking Key Questions

It is helpful to be aware of the ethical levels of a situation and the possible interaction between these levels when confronting a question that has moral implications. The following questions can be asked when a problematic decision or action is perceived (before it becomes an ethical dilemma):

- What are my core values and beliefs?
- What are the core values and beliefs of my organization?
- Whose values, beliefs, and interests may be at risk in this decision? Why?
- Who will be harmed or helped by my decision or by the decision of my organization?
- How will my own and my organization's core values and beliefs be affected or changed by this decision?
- How will I and my organization be affected by the decision?

Figure 1.4 offers a graphic to help identify the ethics of the system (i.e., a country or region's customs, values, and laws), your organization (i.e., the written formal and informal acceptable norms and ways of doing business), and your own ethics, values, and standards.

In the following section, popular myths about business ethics are presented to challenge misconceptions regarding the nature of ethics and business. You may take the "Quick Test of Your Ethical Beliefs" before reading this section.

## ETHICAL INSIGHT 1.1

**Quick Test of Your Ethical Beliefs**

Answer each question with your first reaction. Circle the number, from 1 to 4, that best represents your beliefs, if 1 represents “completely agree” and 4 represents “completely disagree.”

1. I consider money to be the most important reason for working at a job or in an organization. 1 2 3 4
2. I would hide truthful information about someone or something at work to save my job. 1 2 3 4
3. Lying is usually necessary to succeed in business. 1 2 3 4
4. Cutthroat competition is part of getting ahead in the business world. 1 2 3 4
5. I would do what is needed to promote my own career in a company, short of committing a serious crime. 1 2 3 4
6. Acting ethically at home and with friends is not the same as acting ethically on the job. 1 2 3 4
7. Rules are for people who don't really want to make it to the top of a company. 1 2 3 4
8. I believe that the “Golden Rule” is that the person who has the gold rules. 1 2 3 4
9. Ethics should be taught at home and in the family, not in professional or higher education. 1 2 3 4
10. I consider myself the type of person who does whatever it takes to get a job done, period. 1 2 3 4

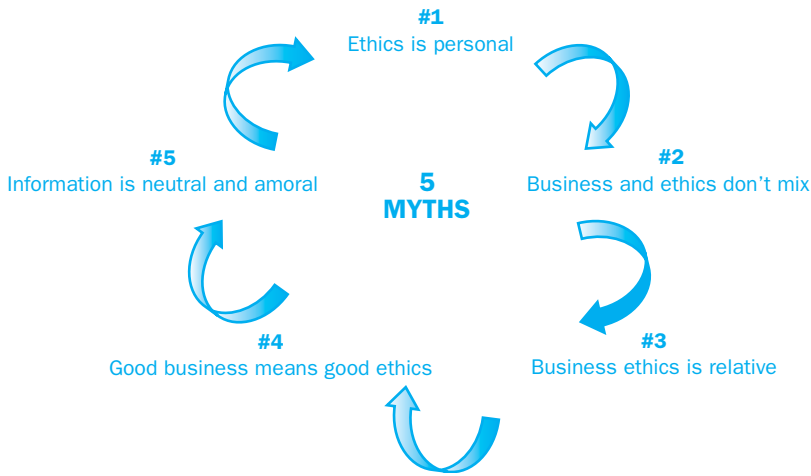
Total your scores by adding up the numbers you circled. The lower your score, the more questionable your ethical principles regarding business activities. The lowest possible score is 10, the highest score is 40. Be ready to give reasons for your answers in a class discussion

**1.4 FIVE MYTHS ABOUT BUSINESS ETHICS**

Not everyone agrees that ethics is a relevant subject for business education or dealings. Some have argued that “business ethics” is an oxymoron, or a contradiction in terms. Although this book does not advocate a particular ethical position or belief system, it argues that ethics is relevant to business transactions. However, certain myths persist about business ethics. The more popular myths are presented in Figure 1.5.

A myth is “a belief given uncritical acceptance by the members of a group, especially in support of existing or traditional practices and institutions.” Myths regarding the relationship between business and ethics do not represent truth but popular and unexamined notions. Which myths have you accepted as unquestioned truth? Do you agree that the following myths are indeed myths? Do you know anyone who holds any of these myths as true?

● Figure 1.5

**Five Business Ethics Myths**

### Myth 1: Ethics Is a Personal, Individual Affair, Not a Public or Debatable Matter

This myth holds that individual ethics is based on personal or religious beliefs, and that one decides what is right and wrong in the privacy of one's conscience. This myth is supported in part by Milton Friedman, a well-known economist, who views "social responsibility," as an expression of business ethics, to be unsuitable for business professionals to address seriously or professionally because they are not equipped or trained to do so.<sup>25</sup>

Although it is true that individuals must make moral choices in life, including business affairs, it is also true that individuals do not operate in a vacuum. Individual ethical choices are most often influenced by discussions, conversations, and debates, and made in group contexts. Individuals often rely on organizations and groups for meaning, direction, and purpose. Moreover, individuals are integral parts of organizational cultures, which have standards to govern what is acceptable. Therefore, to argue that ethics related to business issues is mainly a matter of personal or individual choice is to belittle the role organizations play in shaping and influencing members' attitudes and behavior.

Studies indicate that organizations that act in socially irresponsible ways often pay penalties for unethical behavior.<sup>26</sup> In fact, integrating ethics into the strategic management process is advocated (e.g., "doing well by doing good"). It is argued that integrating ethics into the strategic management process is the right thing and the profitable thing to do. Corporate social performance has been found to increase financial performance. One study clearly shows that "analysis of corporate failures and disasters strongly suggests that incorporating ethics in before-profit decision making can improve strategy development and implementation and ultimately maximize corporate profits."<sup>27</sup> Moreover, the popularity of books, training, and articles on learning organizations and the habits of highly effective people among Fortune 500 and 1000 companies suggests that organizational leaders and professionals have a need for purposeful, socially responsible management training and practices.<sup>28</sup>

## Myth 2: Business and Ethics Do Not Mix

This popular myth<sup>29</sup> holds that business practices are basically amoral—not necessarily immoral—because businesses operate in a free market. This myth also asserts that management is based on scientific, rather than religious or ethical, principles.

Although this myth may have thrived in an earlier industrializing U.S. society and even during the 1960s, the myth has eroded over the past two decades. The widespread consequences of computer hacking on individual, commercial, and government systems that affect the public's welfare, like identity theft on the Internet (stealing others' Social Security numbers and using their bank accounts and credit cards), and kickbacks, unsafe products, oil spills, toxic dumping, air and water pollution, and improper use of public funds have contributed to the erosion. The international and national infatuation with a purely scientific understanding of U.S. business practices, in particular, and of a value-free marketing system, has been undermined by these events. As one saying goes, "A little experience can inform a lot of theory."

The ethicist Richard DeGeorge has noted that the belief that business is amoral is a myth because it ignores the business involvement of all of us. Business is a human activity, not simply a scientific one, and, as such, can be evaluated from a moral perspective. If everyone in business acted amorally or immorally, as a pseudoscientific notion of business would suggest, businesses would collapse. Employees would openly steal from employers; employers would recklessly fire employees at will; contractors would arrogantly violate obligations; chaos would prevail. In the United States, business and society often share the same values: rugged individualism in a free-enterprise system, pragmatism over abstraction, freedom, and independence. When business practices violate these American values, society and the public are threatened.

Finally, the belief that businesses operate in totally "free markets" is debatable. Although the value or desirability of the concept of a "free market" is not in question, practices of certain firms in free markets are. At issue are the unjust methods of accumulation and noncompetitive uses of wealth and power in the formation of monopolies and oligopolies (i.e., small numbers of firms dominating the rules and transactions of certain markets). The dominance of AT&T before its breakup is an example of how one powerful conglomerate could control the market. Microsoft and Wal-Mart may be other examples. The U.S. market environment can be characterized best as a "mixed economy" based on free-market mechanisms, but not limited to or explained only by them. Mixed economies rely on some governmental policies and laws for control of deficiencies and inequalities. For example, protective laws are still required, such as those governing minimum wage, antitrust situations, layoffs from plant closings, and instances of labor exploitation. In such mixed economies in which injustices thrive, ethics is a lively topic.

## Myth 3: Ethics in Business Is Relative

This is one of the more popular myths, and it holds that no right or wrong way of believing or acting exists. Right and wrong are in the eyes of the beholder.

The claim that ethics is not based solely on absolutes has some truth to it. However, to argue that all ethics is relative contradicts everyday experience. For example, the view that because a person or society believes something to be right makes it right is problematic when examined. Many societies believed in and practiced slavery; however, in contemporary individuals' experiences, slavery is morally wrong. When individuals and firms do business in societies that promote slavery, does that mean that the individuals and firms also must condone and practice slavery? The simple logic of relativism, which is discussed in Chapter 3, gets complicated when seen in daily experience. The question that can be asked regarding this myth is, "Relative to whom or what? And why?" The logic of this ethic, which answers that question with "Relative to me, myself, and my interests" as a maxim, does not promote community. Also, if ethical relativism were carried to its logical extreme, no one could disagree with anyone about moral issues because each person's values would be true for him or her. Ultimately, this logic would state that no right or wrong exists apart from an individual's or society's principles. How could interactions be completed if ethical relativism was carried to its limit? Moreover, the U.S. government, in its vigorous pursuit of Microsoft, certainly has not practiced a relativist style of ethics.

#### **Myth 4: Good Business Means Good Ethics**

The reasoning here<sup>30</sup> is that executives and firms that maintain a good corporate image, practice fair and equitable dealings with customers and employees, and earn profits by legitimate, legal means are de facto ethical. Such firms, therefore, would not have to be concerned explicitly with ethics in the workplace. Just do a hard, fair day's work, and that has its own moral goodness and rewards.

The faulty reasoning underlying this logic is that ethics does not always provide solutions to technical business problems. Moreover, as Buchholz<sup>31</sup> argued, no correlation exists between "goodness" and material success.

It also argues that "excellent" companies and corporate cultures have created concern for people in the workplace that exceeds the profit motive. In these cases, excellence seems to be related more to customer service, to maintenance of meaningful public and employee relationships, and to corporate integrity than to profit motive.<sup>32</sup>

The point is that ethics is not something added to business operations; it is necessary to managing successfully. A more accurate, logical statement from business experience would suggest that "good ethics means good business." This is more in line with observations from successful companies that are ethical first and also profitable.

Finally, "What happens, then, if what should be ethically done is not the best thing for business? What happens when good ethics is not good business?"

The ethical thing to do may not always be in the best interests of the firm. We should promote business ethics, not because good ethics is good business, but because we are morally required to adopt the moral point of view in all our dealings with other people—and business is no exception. In business, as in all other human endeavors, we must be prepared to pay the costs of ethical behavior. The costs may sometimes seem high, but that is the risk we take in valuing and preserving our integrity.<sup>33</sup>

## Myth 5: Information and Computing Are Amoral

This myth holds that information and computing are neither moral nor immoral but are amoral. They are in a “gray zone,” a questionable area regarding ethics. Information and computing have positive dimensions, such as empowerment and enlightenment through the ubiquitous exposure to information, increased efficiency, and quick access to online global communities. It is also true that information and computing have a dark side: Information about individuals can be used as “a form of control, power, and manipulation.”<sup>34</sup>

The point here is to beware the dark side: the misuse of information and computing. Ethical implications are present but veiled. Truth and accuracy must be protected and guarded: “Falsehood, inaccuracy, lying, deception, disinformation, misleading information are all vices and enemies of the Information Age, for they undermine it. Fraud, misrepresentation, and falsehood are inimical to all of them.”<sup>35</sup>

Logical problems occur in all five of these myths. In many instances, the myths hold simplistic and even unrealistic notions about ethics in business dealings. In the following sections, the discussion about the nature of business ethics continues by exploring two questions:

- Why use ethical reasoning in business?
- What is the nature of ethical reasoning?

## 1.5 WHY USE ETHICAL REASONING IN BUSINESS?

Ethical reasoning is required in business for at least three reasons. First, many times laws do not cover all aspects or “gray areas” of a problem.<sup>36</sup> How could tobacco companies have been protected by the law for decades until the settlement in 1997, when the industry agreed to pay \$368.5 billion for the first 25 years and then \$15 billion a year indefinitely to compensate states for the costs of health care for tobacco-related illnesses? What gray areas in federal and state laws (or the enforcement of those laws) prevailed for decades? What sources of power or help can people turn to in these situations for truthful information, protection, and compensation when laws are not enough?

Second, free-market and regulated-market mechanisms do not effectively inform owners and managers how to respond to complex issues that have far-reaching ethical consequences. Enron’s former CEO Jeffrey Skilling believed that his new business model of Enron as an energy trading company was the next big breakthrough in a free-market economy. The idea was innovative and creative; the executive’s implementation of the idea was illegal. Perhaps Skilling should have followed Enron’s ethics code; it was one of the best available.

A third argument holds that ethical reasoning is necessary because complex moral problems require “an intuitive or learned understanding and concern for fairness, justice, [and] due process to people, groups, and communities.”<sup>37</sup> Company policies are limited in scope in covering



human, environmental, and social costs of doing business. Judges have to use intuition and a kind of learn-as-you-go approach in many of their cases. In Microsoft's previous alleged monopoly case, for example, there were no clear precedents in the software industry—or with a company of Microsoft's size and global scope—to offer clear legal direction. Ethics, then, plays a role in business because laws are, many times, insufficient to guide action.

## 1.6 CAN BUSINESS ETHICS BE TAUGHT AND TRAINED?

Because laws and legal enforcement are not always sufficient to help guide or solve complex human problems relating to business situations, some questions arise: Can ethics help? If so, how? And can business ethics be taught? This ongoing debate has no final answer, and studies continue to address the issue. One study, for example, that surveyed 125 graduate and undergraduate students in a business ethics course at the beginning of a semester showed that students did not reorder their priorities on the importance of ten social issues at the end of the semester, but they did change the degree of importance they placed on the majority of the issues surveyed.<sup>38</sup> What, if any, value can be gained from teaching ethical principles and training people to use them in business?

This discussion begins with “what business ethics courses cannot or should not, in my judgment, do.” Ethics courses should not advocate a set of rules from a single perspective or offer only one best solution to a specific ethical problem. Given the circumstances of situations, more desirable and less desirable courses of action may exist. Decisions depend on facts, inferences, and rigorous, ethical reasoning. Neither should ethics courses or training sessions promise superior or absolute ways of thinking and behaving in situations. Informed and conscientious ethical analysis is not the only way to reason through moral problems.

Ethics courses and training can do the following:<sup>39</sup>

- Provide people with rationales, ideas, and vocabulary to help them participate effectively in ethical decision-making processes
- Help people “make sense” of their environments by abstracting and selecting ethical priorities
- Provide intellectual weapons to do battle with advocates of economic fundamentalism and those who violate ethical standards
- Enable employees to act as alarm systems for company practices that do not meet society's ethical standards
- Enhance conscientiousness and sensitivity to moral issues, and commitment to finding moral solutions
- Enhance moral reflectiveness and strengthen moral courage
- Increase people's ability to become morally autonomous, ethical dissenters, and the conscience of a group
- Improve the moral climate of firms by providing ethical concepts and tools for creating ethical codes and social audits

Other scholars argue that ethical training can add value to the moral environment of a firm and to relationships in the workplace in the following ways:<sup>40</sup>

- Finding a match between an employee's and employer's values
- Managing the push-back point, where an employee's values are tested by peers, employees, and supervisors
- Handling an unethical directive from a boss
- Coping with a performance system that encourages cutting ethical corners

Teaching business ethics and training people to use them does not promise to provide answers to complex moral dilemmas. However, thoughtful and resourceful business ethics educators can facilitate the development of awareness of what is ethical, help individuals and groups realize that their ethical tolerance and decision-making styles decrease unethical blind spots, and enhance discussion of moral problems openly in the workplace.

Finally, a useful framework for evaluating ethics training is Lawrence Kohlberg's study<sup>41</sup> of the stages of moral development, as well as studies on the relevance of Kohlberg's study for managers and professionals.<sup>42</sup>

## Stages of Moral Development

Kohlberg's three levels of moral development (which encompass six stages) offer a guide for observing a person's level of moral maturity, especially as he or she engages in different organizational transactions. Whether, and to what extent, ethical education and training contribute to moral development in later years is not known. Most individuals in Kohlberg's 20-year study (limited to males) reached the fourth and fifth stages by adulthood. Only a few attained the sixth stage. Still, this framework is used in ethics classrooms and training centers around the globe.

### Level 1: Preconventional Level (Self-Orientation)

- Stage 1: Punishment avoidance: avoiding punishment by not breaking rules. The person has little awareness of others' needs.
- Stage 2: Reward seeking: acting to receive rewards for oneself. The person has awareness of others' needs but not of right and wrong as abstract concepts.

### Level 2: Conventional Level (Others Orientation)

- Stage 3: Good person: acting "right" to be a "good person" and to be accepted by family and friends, not to fulfill any moral ideal.
- Stage 4: Law and order: acting "right" to comply with law and order and norms in societal institutions.

### Level 3: Postconventional, Autonomous, or Principles Level (Universal, Humankind Orientation)

- Stage 5: Social contract: acting "right" to reach consensus by due process and agreement. The person is aware of relativity of values and tolerates differing views.
- Stage 6: Universal ethical principles: acting "right" according to universal, abstract principles of justice and rights. The person reasons and uses conscience and moral rules to guide actions.

## Kohlberg's Study and Business Ethics

One study of 219 corporate managers working in different companies found that managers typically reason at moral stage 3 or 4, which, the author noted, is “similar to most adults in the Western, urban societies or other business managers.”<sup>43</sup> Managers in large- to medium-sized firms reasoned at lower moral stages than managers who were self-employed or who worked at small firms. Reasons offered for this difference in moral reasoning include that larger firms have more complex bureaucracies and layers of structure, more standard policies and procedures, and exert more rule-based control over employees. Employees tend to get isolated from other parts of the organization and feel less involved in the central decision-making process.

On the other hand, self-employed professionals and managers in smaller firms tend to interact with people throughout the firm and with external stakeholders. Involvement with and vulnerability to other stakeholders may cause these managers to adhere to social laws more closely and to reason at stage 4.

This study also found that managers reasoned at a higher level when responding to a moral dilemma in which the main character was not a corporate employee. It could be that managers reason at a higher level when moral problems are not associated with the corporation. The author suggested that the influence of the corporation tends to restrict the manager to lower moral reasoning stages. Or it could be that the nature of the moral dilemma may affect the way managers reason (e.g., some dilemmas may be appropriately addressed with stage 3 or 4 reasoning, other dilemmas may require stage 5 logic). This study raises the question: “How can organizations use these findings in training and managing people?”

Another important study argued that moral decision making is “issue dependent” and, more specifically, that “the moral intensity of the issue itself has a significant effect on moral decision making and behavior at all stages of the process.” In fact, the authors argue that “issues of high moral intensity will be recognized as moral issues more frequently than will issues of low moral intensity.”<sup>44</sup> The study suggests that people who do not recognize moral issues will not act morally regarding those issues. This conclusion supports a serious need for business ethics education and training with specific emphasis on identifying stakeholder and issues management.

## 1.7 PLAN OF THE BOOK

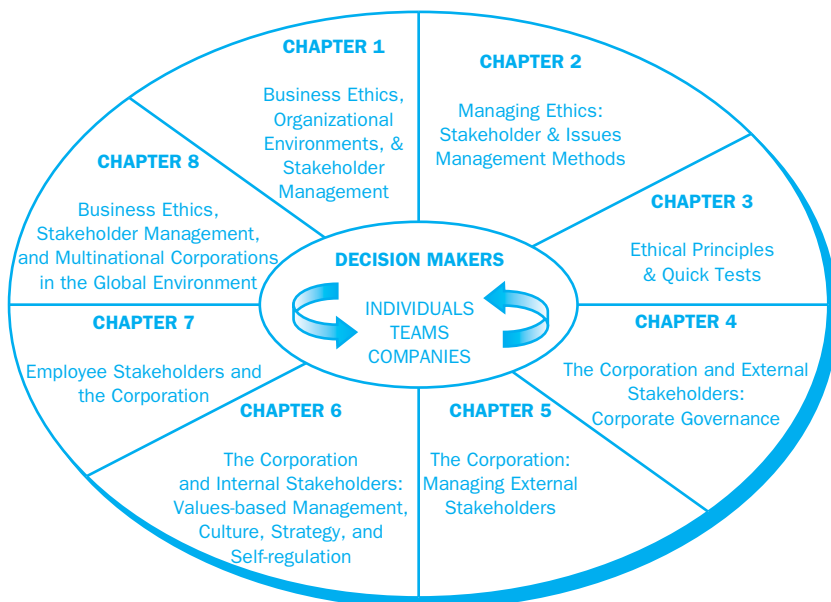
This book focuses on applying stakeholder and issues-management approaches along with your own critical reasoning to situations that involve groups and individuals who often have competing interpretations of a problem or opportunity. Because stakeholders are people, they generally act on beliefs, values, and financially motivated strategies. For this reason, ethics and values-based thinking is an important part of a stakeholder

issues-management approach. It is important to understand why stakeholders act and how they make decisions. The stakeholder management approach ideally aims at having all parties reach win-win outcomes through communication and collaborative efforts. Unfortunately, this does not always happen. If we do not have a systematic approach to understanding what happens in complex stakeholder relationships, we cannot learn from past mistakes or plan for more collaborative, socially responsible future outcomes. A schematic of the book's organization is presented in Figure 1.6.

Chapter 2 provides a systematic approach for structuring and evaluating stakeholder issues, strategies, and options at the outset. Step-by-step methods for collaborating and for forming and evaluating strategies are identified. Chapter 3 provides ethical principles, "quick tests," and scenarios for evaluating motivations for certain decisions and actions. A stakeholder management approach involves knowing and managing stakeholders' ethics, including your own. Chapter 4 examines an organization's corporate governance and compliance. Chapter 5 looks at how organizations manage external and business issues stakeholders. Chapter 6 looks at internal stakeholders, strategy, culture, and self-regulation in corporations and discusses rights and obligations of employees and employers as stakeholders. Chapter 7 analyzes current trends affecting employees in corporations. Chapter 8 examines globalization and views nations as stakeholders and looks at how multinational corporations operate in host countries and different systems of capitalism.

Figure 1.6

### Plan of the Book



## CHAPTER SUMMARY

Businesses and governments operate in numerous environments, including technological, legal, social, economic, and political dimensions. Understanding the effects of these environmental forces on industries and organizations is a first step in identifying stakeholders and the issues that different groups must manage in order to survive and compete. This book explores and illustrates how stakeholders can manage issues and trends in their changing environments in socially responsible, principled ways. Thinking and acting ethically is not a mechanical process; it is also very personal. It is important as a professional in an organization to integrate personal with professional experiences and values.

Business ethics deals with what is “right” and “wrong” in organizational decisions, behavior, and policies. Business ethics provides principles and guidelines that assist people in making informed choices that balance economic interests and social responsibilities. Being able to think of other stakeholders’ interests can better inform the moral dimension of your own decisions. This is one aim of using a stakeholder approach.

Seeing the “big picture” of how ethical issues begin and transform requires imagination and some “maps.” Because business ethics apply to several levels, this chapter presents these levels to illustrate the complexity of ethical decision making in business transactions. When you can “connect the dots” among these dimensions, more options for solving problems morally are opened.

The stakeholder approach also provides a means for mapping complicated relationships between the focal and other stakeholders, a means of identifying the strategies of each stakeholder, and a means for assessing the moral responsibility of all the constituencies.

Five myths often held about business ethics are discussed. Each myth is illustrated and refuted. You are invited to identify and question your own myths about business ethics. Ethical reasoning in business is explained with steps to guide decision making. Here are three reasons why ethical reasoning is necessary in business: (1) Laws are often insufficient and do not cover all aspects or “gray areas” of a problem; (2) free-market and regulated-market mechanisms do not effectively inform owners and managers on how to respond to complex crises that have far-reaching ethical consequences; and (3) complex moral problems require an understanding and concern for fairness, justice, and due process. Ethical reasoning helps individuals sort through conflicting opinions and information in order to solve moral dilemmas.

Ethical education and training can be useful for developing a broad awareness of the motivations, values, and consequences of our decisions. Business ethics does not, however, provide superior or universally correct solutions to morally complex dilemmas. Principles and guidelines are provided that can enhance—with case analysis, role playing, and group discussion—a person’s insight and self-confidence in resolving moral dilemmas that often have two right (or wrong) solutions. Kohlberg’s stages of moral development are presented and discussed as a means of assisting professionals and managers with ethical decision making by identifying underlying moral arguments and motivations.

## QUESTIONS

1. Refer to Figure 1.1 to identify three specific environmental influences that the organization for which you work (or the institution in which you study) must address to survive and be competitive. Explain. How do these influences, pressures, and opportunities affect you, and how ethically do you accomplish your work and goals?
2. What are the three major ethical issues you face now in your work or student life? What is “ethical” about these issues?
3. Identify some benefits of using a stakeholder approach in ethical decision making. How would using a stakeholder approach help you plan and/or solve an ethical issue in your working life? Explain.
4. Which, if any, of the five business myths in the chapter do you not accept as a myth (i.e., that you believe is true)? Explain.
5. Identify one myth you had/have about business ethics. Where did it originate? Why is it a “myth”? What led you to abandon this myth, or do you still believe in it? Explain.
6. Identify three reasons presented in this chapter for using ethical reasoning in business situations. Which of these reasons do you find the most valid? The least valid? Explain.
7. Is the law sufficient to help managers and employees solve ethical dilemmas? Explain and offer an example from your own experiences or from a contemporary event.
8. What are some important distinctive characteristics of ethical problems? What distinguishes an ethical from a legal problem?
9. What (if any) specific attitudes, values, beliefs, or behaviors of yours do you think could be changed from an ethics course? Explain.
10. Identify and describe a specific belief or behavior of yours that you feel could be changed through taking a course in ethics.

## EXERCISES

1. Invent and state your own definition of “business ethics.” Do you believe that ethics is an important factor in business transactions today? If you were the CEO of a corporation, how would you communicate your perspective on the importance of ethics to your employees, customers, and other stakeholder groups?
2. Conduct your own small survey of two people regarding their opinions on the importance of unethical practices in businesses today. Do your interviewees give more importance to economic performance or socially irresponsible behavior? Or do they think other factors are more important? Summarize your results.
3. You are giving a speech at an important community business association meeting. You are asked to give a presentation called “an introduction to business ethics” for the members. Give an outline of your speech.

4. Explain how a major trend in the environment has affected your profession, job, or skills—as a professional or student. Be specific. Are any ethical consequences involved, and has this trend affected you?
5. Review Kohlberg's levels and stages of moral development. After careful consideration, briefly explain which stage, predominantly or characteristically, defines your ethical level of development. Explain. Has this stage influenced a recent decision you have made or action you have taken? Explain.
6. How can Kohlberg's framework assist professionals in organizations to see, prevent, and solve ethical problems and dilemmas?
7. You are applying to a prestigious organization for an important, highly visible position. The application requires you to describe an ethical dilemma in your history and how you handled it. Describe the dilemma and your ethical position.

**REAL-TIME ETHICAL DILEMMA**

You are a staff associate at a major public accounting firm and graduated from college two years ago. You are working on an audit for a small, non-profit religious publishing firm. After performing tests on the royalty payables system, you discover that for the past five years, the royalty payable system has miscalculated the royalties it owes to authors of their publications. The firm owes almost \$100,000 in past due royalties. All of the contracts with each author are negotiated differently. However, each author's royalty percentage will increase at different milestones in books sold (i.e., 2% up to 10,000 and 3% thereafter). The software package did not calculate the increases, and none of the authors ever received their increase in royalty payments. At first you can't believe that none of the authors ever realized they were owed their money. You double check your calculations and then present your findings to the senior auditor on the job. Much to your surprise, his suggestion is to pass over this finding. He suggests that you sample a few additional royalty contracts and document that you expanded your testing and found nothing wrong. The firm's audit approach is well documented in this area and is firmly based on statistical sampling. Because you had found multiple errors in the small number of royalty contracts tested, the firm's approach suggested testing 100% of the contracts. This would mean (1) going over the budgeted time/expense estimated to the client; (2) possibly providing a negative audit finding; and (3) confirming that the person who audited the section in the years past may not have performed procedures correctly.

Based on the prior year's work papers, the senior auditor on the job performed the testing phase in all of these years just before his promotion. For some reason, you get the impression that the senior auditor is frustrated with you. The relationship seems strained. He is very intense, constantly checking the staff's progress in the hope of coming in even a half-hour under budget for a designated test/audit area. There's a lot of pressure, and you don't know what to do. This person is responsible for writing your review for your personnel file and bonus or promotion review. He is a very popular employee who is "on the fast track" to partnership.

You don't know whether to tell the truth and risk a poor performance review and jeopardize your future with this company or to tell the truth, hopefully be exonerated, and be able to live with yourself by "doing the right thing" and facing consequences with a clean conscience.

**Questions**

1. What would you do as the staff associate in this situation? Why? What are the risks of telling the truth for you? What are the benefits? Explain.
2. What is the "right" thing to do in this situation? What is the "smart" thing to do for your job and career? What is the difference, if there is one, between the "right" and "smart" thing to do in this situation? Explain.
3. Explain what you would say to the senior auditor, your boss, in this situation if you decided to tell the truth as you know it.



## Case 1

### Enron: What Caused the Ethical Collapse?

#### Introduction

"Enron, once the nation's seventh-largest company, crumbled into bankruptcy in December 2001 after years of accounting tricks could no longer hide billions in debt or make failing ventures appear profitable. The collapse wiped out thousands of jobs, more than \$60 billion in market value and more than \$2 billion in pension plans . . . Enron founder Kenneth Lay and former chief executive Jeffrey Skilling were convicted in 2006 for their roles in the company's collapse. Skilling is serving a sentence of more than 24 years. Lay's convictions for conspiracy, fraud and other charges were wiped out after he died of heart disease in 2006 . . . Three British bankers were sentenced Friday to just over three years in prison for their roles in a fraudulent scheme with former Enron Chief Financial Officer Andrew Fastow . . ." *The Huffington Post*, February 22, 2008.

Andrew Fastow was sentenced to six years and agreed to pay back \$24 million.

Enron may be gone, but it should not be forgotten—especially by a new generation of corporate leaders, and by accounting, finance, and management students who may find themselves working in similar circumstances under leaders with questionable motives and criminal intent. Kenneth Lay, former chairman and CEO of Enron Corp., is quoted in Michael Novak's book *Business as a Calling: Work and the Examined Life* as saying, "I was fully exposed to not only legal behavior but moral and ethical behavior and what that means from the standpoint of leading organizations and people." In an introductory statement to the revised *Enron Code of Ethics* issued in July 2000, Lay wrote:

"As officers and employees of Enron Corp., its subsidiaries, and its affiliated companies, we are responsible for conducting the business affairs of the companies in accordance with all applicable laws and in a moral and honest manner." Lay went on to indicate that the 64-page *Enron Code of Ethics* reflected policies approved of by the company's board of directors and that the company, which enjoyed a reputation for being fair and honest, was highly respected. Enron's ethics code also specified that "an employee shall not conduct himself or herself in a manner which directly or indirectly would be detrimental to the best interests of the Company or in a manner which would bring to the employee financial gain separately derived as a direct consequence of his or her employment with the Company."

Enron's ethics code was based on respect, integrity, communication, and excellence. These values were described as follows:

**Respect.** We treat others as we would like to be treated ourselves. We do not tolerate abusive or disrespectful treatment. Ruthlessness, callousness and arrogance don't belong here.

**Integrity.** We work with customers and prospects openly, honestly and sincerely. When we say we will do something, we will do it; when we say we cannot or will not do something, then we won't do it.

**Communication.** We have an obligation to communicate. Here we take the time to talk with one another . . . and to listen. We believe that information is meant to move and that information moves people.

**Excellence.** We are satisfied with nothing less than the very best in

everything we do. We will continue to raise the bar for everyone. The great fun here will be for all of us to discover just how good we can really be.

Given this code of conduct and Ken Lay's professed commitment to business ethics, how could Enron have collapsed so dramatically, going from reported revenues of \$101 billion in 2000 and approximately \$140 billion during the first three quarters of 2001 to declaring bankruptcy in December 2001? The answer to this question seems to be rooted in a combination of the failure of top leadership, a corporate culture that supported unethical behavior, and the complicity of the investment banking community.

**Enron's Top Leadership** In the aftermath of Enron's bankruptcy filing, numerous Enron executives were charged with criminal acts, including fraud, money laundering, and insider trading. For example, Ben Glisan, Enron's former treasurer, was charged with two dozen counts of money laundering, fraud, and conspiracy. Glisan pled guilty to one count of conspiracy to commit fraud and received a prison term, three years of post-prison supervision, and financial penalties of more than \$1 million. During the plea negotiations, Glisan described Enron as a "house of cards."

Andrew Fastow, Jeff Skilling, and Ken Lay were among the most notable top-level executives implicated in the collapse of Enron's "house of cards." Andrew Fastow, former Enron chief financial officer (CFO), faced 98 counts of money laundering, fraud, and conspiracy in connection with the improper partnerships he ran, which included a Brazilian power plant project and a Nigerian power plant project that was aided by Merrill Lynch, an investment banking firm. Fastow pled guilty to one charge of conspiracy to commit wire fraud and one charge of conspiracy to commit wire and securities fraud. He received a six-year sentence and will forfeit \$24 million of

illegal gains. Jeff Skilling was indicted on 35 counts of wire fraud, securities fraud, conspiracy, making false statements on financial reports, and insider trading, and was sentenced to 24 years. Ken Lay was indicted on 11 criminal counts of fraud and making misleading statements, and died in 2006.

The activities of Skilling, Fastow, and Lay raise questions about how closely they adhered to the values of respect, integrity, communication, and excellence articulated in the *Enron Code of Ethics*. Before the collapse, when Bethany McLean, an investigative reporter for *Fortune* magazine, was preparing an article on how Enron made its money, she called Enron's then CEO, Jeff Skilling, to seek clarification of its "nearly incomprehensible financial statements." Skilling became agitated with McLean's inquiry, told her that the line of questioning was unethical, and hung up on McLean. Shortly thereafter Andrew Fastow and two other key executives traveled to New York City to meet with McLean, ostensibly to answer her questions "completely and accurately."

Fastow engaged in several activities that challenge the foundational values of the company's ethics code. Fastow tried to conceal how extensively Enron was involved in trading for the simple reason that trading companies have inherently volatile earnings that aren't rewarded in the stock market with high valuations—and a high market valuation was essential to keeping Enron from collapsing. Another Fastow venture was setting up and operating partnerships called "related party transactions" to do business with Enron. In the process of allowing Fastow to set up and run these very lucrative private partnerships, Enron's board and top management gave Fastow an exemption from the company's ethics code.

Contrary to the federal prosecutor's indictment of Lay, which described him as one of the key leaders and organizers of the criminal activity and massive fraud that led to Enron's bankruptcy, Lay maintained his innocence and lack

of knowledge of what was happening. He blamed virtually all of the criminal activities on Fastow. However, Sherron Watkins, the key Enron whistle-blower, maintained that she could provide examples of Lay's questionable decisions and actions. As Bethany McLean and fellow investigative reporter Peter Elkind observed: "Lay [bore] enormous responsibility for the substance of what went wrong at Enron. The problems ran wide and deep, as did the deception required in covering them up. The company's culture was his to shape." Ultimately, the actions of Enron's leadership did not match the company's expressed vision and values.

**Enron's Corporate Culture** Enron has been described as having a culture of arrogance that led people to believe that they could handle increasingly greater risk without encountering any danger. According to Sherron Watkins, "Enron's unspoken message was, 'Make the numbers, make the numbers, make the numbers—if you steal, if you cheat, just don't get caught. If you do, beg for a second chance, and you'll get one.'" Enron's corporate culture did little to promote the values of respect and integrity. These values were undermined through the company's emphasis on decentralization, its employee performance appraisals, and its compensation program.

Each Enron division and business unit was kept separate from the others, and as a result very few people in the organization had a "big picture" perspective of the company's operations. Accompanying this emphasis on decentralization were insufficient operational and financial controls as well as "a distracted, hands-off chairman, a compliant board of directors, and an impotent staff of accountants, auditors, and lawyers."

Jeff Skilling implemented a very rigorous and threatening performance evaluation process for all Enron employees. Known as "rank and yank," the annual process utilized peer evaluations,

and each of the company's divisions was arbitrarily forced to fire the lowest-ranking one-fifth of its employees. Employees frequently ranked their peers lower in order to enhance their own positions in the company.

Enron's compensation plan "seemed oriented toward enriching executives rather than generating profits for shareholders" and encouraged people to break rules and inflate the value of contracts even though no actual cash was generated. Enron's bonus program encouraged the use of nonstandard accounting practices and the inflated valuation of deals on the company's books. Indeed, deal inflation became widespread within the company as partnerships were created solely to hide losses and avoid the consequences of owning up to problems.

**Complicity of the Investment Banking Community** According to investigative reporters McLean and Elkind, "One of the most sordid aspects of the Enron scandal is the complicity of so many highly regarded Wall Street firms" in enabling Enron's fraud as well as being partners to it. Included among these firms were J.P. Morgan, Citigroup, and Merrill Lynch. This complicity occurred through the use of *prepays*, which were basically loans that Enron booked as operating cash flow. Enron secured new prepays to pay off existing ones and to support rapidly expanding investments in new businesses.

One of the related party transactions created by Andrew Fastow, known as LJM2, used a tactic whereby it would take "an asset off Enron's hands—usually a poor performing asset, usually at the end of a quarter—and then sell it back to the company at a profit once the quarter was over and the 'earnings' had been booked." Such transactions were basically smoke and mirrors, reflecting a relationship between LJM2 and the banks wherein "Enron could practically pluck earnings out of thin air."

## Questions for Discussion

1. What led to the eventual collapse of Enron under Lay and Skilling?
2. How did the top leadership at Enron undermine the foundational values of the *Enron Code of Ethics*?
3. In retrospect: given Kenneth Lay's and Jeff Skilling's operating beliefs and the *Enron Code of Ethics*, what expectations regarding ethical decisions and actions should Enron's employees reasonably have had?
4. How did Enron's corporate culture promote unethical decisions and actions?
5. How did the investment banking community contribute to the ethical collapse of Enron?
6. If the Sarbanes-Oxley law had been in effect, do you believe the Enron debacle would have occurred? Explain.
7. Could another Enron occur now? Why or why not? Explain.

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## Case 2

### Microsoft: The Next Chapter

#### A Case Study on Microsoft's Competitive Practices and Business Strategy

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**Introduction** Microsoft, one of the top software companies to emerge during the information age, continues to fight a long, drawn-out antitrust battle with European Union (EU) regulators. Microsoft settled part of its antitrust case with the United States Department of Justice (DOJ) and 20 state attorneys general in 2004; the company is still under oversight by the Department of Justice until 2009. Observers note that maybe the EU can obtain just concessions from the company that the U.S. DOJ could not and has not. More recently, "The [EU] Commission hit Microsoft with a \$781m (497m euros) fine and again, later, with a fine of \$440m (280.5m euros) for non compliance after Microsoft lost an appeal against the first fine. The February fine covers the period of non compliance since the second fine through to October 21, 2007." Microsoft has appealed. (*The Register*, July 7, 2008). The venerable software giant is at another critical turning point in its development: it has to either adapt to the changing new global technology environment where collaborative open-source software such as Linux play and team with the likes of Google, or continue to be hounded and fined by the EU.

It appears Microsoft may be cautiously opening up. The company has begun to make changes to its current business model, embracing radical, innovative new thinking, incorporating other companies and technologies into its domains, and pursuing Yahoo! to better position itself in the search business. It has also joined a handful of U.S. companies who wish to dominate the market for "cloud computing"—a domain that incorporates central processing to replace desktops, and that "... involves the centralized storage and processing of information—a shift that could

reduce the role of desktop computers and the servers and other equipment run by many companies . . . ." With regard to business ethics, a major question about Microsoft remains: will the approaches the company takes involve or attempt to dominate and control competitors?

**The Road Less Traveled** Microsoft has focused primarily on product development since January 2005, making acquisitions of complementary businesses (or potential future rivals) along the way. Its chief adversary over the last year and a half has been the European Union, which issued its original antitrust ruling in March 2004 and a more recent fine for noncompliance with the ruling in December 2005. Microsoft has also shifted its marketing focus, tangled with Google over a search engine issue that is loosely reminiscent of the original antitrust claim made by Netscape nearly a decade ago, struggled to buy Yahoo!, and announced a looming change in business strategy alongside an administrative shake-up. Microsoft's attempts to take over Yahoo! have, to date, not succeeded. Both Goggle and Yahoo! do not appear as naive or vulnerable as Microsoft's competitors in the 1990s.

**Monopoly: The Battle with Europe** The U.S. DOJ settled its antitrust case against Microsoft in November 2001, and the state attorneys general followed suit shortly thereafter. The settlement dictated that (1) customers must have a choice about what Windows components are mandatory in any installation of the operating system, and (2) Microsoft must disclose certain information to allow third-party developers to create software that better interoperates with Windows. The end of the DOJ's pursuit of Microsoft essentially closed the door on further

investigations into Microsoft's business practices in the United States, and forced Microsoft's high-profile competition to look elsewhere for support of their assertions of Microsoft's monopolistic tendencies. IBM Corporation, Oracle Corporation, Sun Microsystems, RedHat, RealNetworks, Adobe Systems, and more recently Google have all entreated the European Union to use its authority to regulate Microsoft on their behalf and for the protection of the software giant's myriad customers.

The EU began its antitrust investigation of Microsoft in 1998 when it received a complaint from Sun Microsystems alleging that Microsoft was willfully concealing information that Sun required for its software to successfully interoperate with Microsoft Windows. Subsequently, the EU opened a second unrelated investigation of Microsoft in 2001 when the company began shipping its operating system with freely attached media player software that competed directly with rival offerings such as RealNetworks' RealPlayer.

After five years of investigating Microsoft's tactics, the EU issued antitrust rulings in March 2004 and again in 2008. The EU's decision brought with it a \$613 million fine and required Microsoft to alter its business practices to increase competition in two areas that satisfied both of the independent investigations: (1) Microsoft must not ship Windows with its own embedded media player, and (2) the company was required to produce documentation to assist its rivals in writing Windows Office productivity software.

Meanwhile, Microsoft settled out of court with Sun, Novell Networks, and RealNetworks for a total of more than \$3 billion so that each company would forego its related complaints in both the EU and the United States, which weakened the EU's stance on the antitrust case. However, just over a year later, the EU began receiving complaints that the company still had not made any progress on either tenet of the 2004 antitrust ruling. The commission threatened new fines, and

Microsoft made an effort to adhere to the terms of the ruling and to smooth its relationship with the EU.

Microsoft began shipping its stripped-down version of Windows in Europe in 2005, satisfying the first requirement of the EU ruling. However, a number of meetings and information transfers have ensued regarding the documentation requirement, which neither side has found mutually satisfactory. Microsoft chose to air the conflict to the press, which consummated in July 2006 when the EU levied a \$356 million fine against the software giant for failing to comply with the 2004 ruling. The EU has threatened to fine Microsoft nearly \$4 million each day until the company complies. Microsoft has a number of pending appeals in the EU case, both of the original ruling and of the most recent noncompliance fine.

**A Shift in Business Strategy** While Microsoft's battle with the EU continued, Google filed a complaint with the U.S. DOJ and with the EU's antitrust authorities in March 2006. The complaint alleged that Microsoft had designed its new Internet browser, Internet Explorer (IE) 7, to primarily use a Microsoft search engine, which would place Google at a competitive disadvantage in the Internet search market. However, the DOJ found in May 2006 that the default settings in the browser were not a competitive threat to Google. Industry analyst Paul Thurrott describes the finding:

In a court filing, the DOJ noted that Microsoft had first briefed it about IE 7's search box months ago. The feature is easily modified to use any Internet search engine, including that of Google, the DOJ said, "using a relatively straightforward method for the user to select a different search engine from the initial default." Furthermore, the DOJ wrote, Microsoft's actions with IE 7 are a far cry from the anticompetitive behavior that got the software giant into legal hot water

almost a decade ago. The reason? IE 7 respects changes that the user made prior to installing this version of the browser. If the browser was previously using a search service from Google or Yahoo by default, IE 7 will not change that choice to MSN Search when the product is installed. IE 7 “only uses MSN Search if no default has been set.” The DOJ has “concluded [its] work on this matter,” the filing reads.

This behavior is wildly different from the fiercely anticompetitive and monopolistic tactics that Microsoft has used to thwart its enemies in the past. This change in direction provides direct evidence that a new school of thought is emerging within the old software giant. An atmosphere likened to that of a startup software company is emerging within this large multinational, one that values building trusting relationships with partners. The company has even taken a renewed interest in its marketing initiatives by elevating its Chief Marketing Officer Mich Matthews to directly report to CEO Steve Ballmer. A clear motivator for increased marketing vigor can be directly attributed to the “evil empire” moniker attributed to Microsoft in free-software development and operating system circles, two of the company’s main competitive foes.

Meanwhile, in late April 2006, Microsoft’s share price plummeted 11% in a single day after the company said it would spend \$2.5 billion to compete against rival game consoles and search technology, and to develop online alternatives to the new versions of its Office productivity software and the next version of the Windows operating system, Windows Vista. As Microsoft pours funding into its research arm, the door to the next wave of Internet technology is upon it, and the key to that door will be the Internet browser. Notes *The Economist*: “The extent to which web browsers are open to outside firms is important because they represent a platform for providing services via the Internet, overshadowing

the primacy of the operating system as the platform for PCs. Whoever controls these platforms is in a position to determine what users can do—as well as steer sales.” Service provision via the Internet is that next wave, and innovation in that arena has already begun. Microsoft has reluctantly come to the same conclusion, even if a little late.

The stakes are high in the markets where Microsoft and its closest competitors play. Google’s market share could approach 90% of the search market in the coming year. Microsoft’s sales of Windows Mobile platform products are projected at 40% of the global smartphone market by 2012, according to Eddie Wu, managing director of Microsoft ODM embedded devices, Asia. It is not in Google’s or Microsoft’s interest or competitive nature to allow uncharted markets and technology domains to be dominated without vigorous battles.

Google’s complaint against Microsoft is a result of the integration of browser search technology. This technology will provide access to a myriad of Internet services once it proliferates. Microsoft avoided regulatory hurdles with that particular complaint, but the EU is paying close attention to the features that will be available in Windows Vista and has warned that embedding new, anticompetitive functions into that operating system could violate further antitrust rules in Europe.

With regard to the U.S. Department of Justice’s monopoly case and oversight of Microsoft’s practices, a spokesperson for the company announced that Judge Colleen Kollar-Kotelly’s order, issued at the end of 2008, was extended through November 12, 2009. “The court’s action came in response to requests by a number of states involved in the case to extend the consent decree by five years.”

Microsoft Chairman Bill Gates has always been a firm believer in the power of innovation, and strives to reinvent Microsoft ahead of disruptive technology curves. Microsoft’s current business model relies on charging



license fees for boxed or downloadable software, so the company may control its distribution and use. With the impending paradigm shift to Web services, “cloud computing,” and virtualisation technology, Gates noted in an internal corporate memo that “the coming services wave will be very disruptive”—perhaps even to Microsoft itself. As both Gates and CEO Steve Ballmer also continue to chase Google in the Internet search war, they keep an eye on their rear view mirror at the EU’s regulatory and compliance arm that has proven more effective than the U.S. Department of Justice in constraining the software giant.

### Questions for Discussion

1. Why was Microsoft being pursued by the U.S. Department of Justice and then fined by the EU?
2. What ethic is Microsoft practicing—in the U.S. and now globally? Do you agree with this ethic? Explain.
3. Is Google getting more of a “free pass” than Microsoft in its competitive practices to dominate the search market? Explain.
4. Should Microsoft be legally and ethically constrained as it competes with very aggressive competitors globally and locally? State and defend your position.
5. Is the EU really competing against the U.S. when it takes on Microsoft, or is it just competing against Microsoft? Explain your position.
6. Which stakeholders really stand to win and lose in Microsoft’s quest to be number one in the technology markets it seeks to dominate? Explain and offer evidence.

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# 2

## STAKEHOLDER AND ISSUES MANAGEMENT APPROACHES

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### 2.3 How to Execute a Stakeholder Analysis

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Mattel Toy Recalls

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## OPENING CASE

In early July, 2007, one of Mattel's European retailers discovered lead on some toys. "On July 6th Mattel stopped operations at the factory that produced the toys and initiated an investigation."<sup>1</sup> The toys were produced by Early Light Industrial Co. Ltd which subcontracted the painting of parts to the vendor, Hong Li Da. Both vendors were located in China. The Early Light Industrial Co. Ltd. factory had been a Mattel vendor for 15 years. Mattel had required vendors to use paint that had been provided by

suppliers that were certified. Hong Li Da was required to use paint supplied directly from Early Light but it violated Mattel's standards and used paint from a third party supplier that was not certified.<sup>2</sup> The owner of the Hong Li Da factory that was associated with using lead paint hung himself in a warehouse on August 11, 2007.<sup>3</sup>

On August 2, 2007, Mattel's Fisher-Price subsidiary recalled almost a million toys made in China. The toys were colored using lead-based paint. One recalled toy

had paint that was 200 times over the acceptable limit of lead in the United States. Children who suck on toys with lead could possibly be poisoned. Lead poisoning can result in learning and behavior problems or even death. Lead is cumulative, so it should be removed from a child's environment every time it can.<sup>4</sup>

On August 14, 2007, Mattel recalled an additional 18 million products made between May and July 2007 because of their use of strong magnets that could detach, posing a danger to children. If two or more magnets were digested by children, the magnets would attract each other in the intestines, causing damage. Toys with strong magnets had been on the market since 2003. A toddler died in 2005 after swallowing several magnets of a toy made by Mattel.<sup>5</sup> There were no laws to address the hazards of strong metals and Mattel recalled them after incidents of harm were reported. In this case, the recall did not occur because the company was cutting corners. "Technology advanced faster than toy makers' perceived risk."<sup>6</sup>

The magnets had gone through rigorous stress tests, but the industry had not considered the disastrous effects of a child's swallowing two or more of the magnets. On September 4, 2007, Mattel recalled another 530,000 toys after performing additional tests, and found that these Chinese-made products also contained excessive amounts of lead.<sup>7</sup>

While there are several contributing factors regarding the issues and problems in this case, Mattel's outsourcing relationship with China raises questions. Effective outsourcing occurs when there is a full partnership and sharing of responsibility between companies. If Mattel had engaged its business partners in China with strict random auditing, education, and technology transfer, a more cooperative and accountable relationship may have developed with its manufacturers. Boeing followed such "best practices," and was able to develop an effective outsourcing partnership in which accountability was expected and delivered from its Chinese subcontractor Xi'an.<sup>8</sup> (Additional facts are provided in Case 3 at the end of this chapter.)

## 2.1 WHY USE A STAKEHOLDER MANAGEMENT APPROACH FOR BUSINESS ETHICS?

The stakeholder management approach is a response to the growth and complexity of contemporary corporations and the need to understand how they operate with their stakeholders and stockholders. Stakeholder theory argues that corporations should treat all their constituencies fairly and that doing so can enable the companies to perform better in the marketplace.<sup>9</sup> "If organizations want to be effective, they will pay attention to all and only those relationships that can affect or be affected by the achievement of the organization's purposes."<sup>10</sup>

This chapter applies stakeholder management not only in its theoretical form, but also as a practical method to analyze how companies deal with their stakeholders. We therefore use the term "stakeholder analysis" (which is part of stakeholder management) to identify strategies, actions, and policy results of firms in their management of employees, competitors, the media, courts, and stockholders. Later in the chapter, we introduce "issues management" as another set of methods for managing stakeholders. Issues management and stakeholder management are complementary theories that use similar methods, as we show later. Starting with a major issue or opportunity that a company faces is one way to begin stakeholder analysis.

A more familiar way of understanding corporations is the “stockholder approach,” which focuses on financial and economic relationships. By contrast, a stakeholder management approach is a descriptive method that studies actors.<sup>11</sup> The stakeholder management approach takes into account nonmarket forces that affect organizations and individuals, such as moral, political, legal, and technological interests, as well as economic factors.

Underlying the stakeholder management approach is the ethical imperative that mandates that businesses in their fiduciary relationships to their stockholders: (1) act in the best interests of and for the benefit of their customers, employees, suppliers, and stockholders, and (2) respect and fulfill these stakeholders’ rights. One study concluded that “our analysis clearly reveals that multiple objectives—including both economic and social considerations—can be and, in fact, are simultaneously and successfully pursued within large and complex organizations that collectively account for a major part of all economic activity within our society.”<sup>12</sup>

## **Stakeholder Management Approach: Criticisms and Responses**

The dominant critique of the stakeholder theory by some scholars is that corporations should serve only stockholders since they own the corporation.<sup>13</sup> It is important to observe criticisms of stakeholder theory and responses to these in order to understand the purpose of the stakeholder theory. The following criticisms of stakeholder theory have been offered by scholars:<sup>14</sup> (1) negates and weakens fiduciary duties managers owe to stockholders; (2) weakens the influence and power of stakeholder groups; (3) weakens the firm; and (4) changes the long-term character of the capitalist system. Ethically, these arguments are based on property and implied contract rights, and on fiduciary duties and responsibilities of managers to stockholders.

Critics claim that some stakeholder groups’ power can be weakened by stakeholder theory by treating all stakeholders equally—as stakeholder theory suggests. For example, labor unions can be avoided, hurt, or even eliminated. Corporations can also be weakened in their pursuit of profit if they attempt to serve all stakeholders’ interests. The corporation cannot be all things to all stakeholders and protect stockholders’ fiduciary interest. Finally, critics who claim that stakeholder theory changes the long-term character of capitalism argue that: (1) corporations have no responsibility by law other than to their stockholders, since the market disciplines corporations anyway; and (2) stakeholder theory permits some managers to “game” corporations by arguing that they are protecting some stakeholder interests, even if interests of others are harmed. Some more leftist thinkers also criticize advocates of stakeholder theory as being naive and utopian. These critics claim that well intentioned “do-gooders” ignore or mask the reality of capital labor relationships through simplistic notions in stakeholder theory such as “participation,” “empowerment,” and “realizing human potential.”<sup>15</sup>

Given these criticisms, stakeholder theory continues to be popular and widely used. As noted earlier in this chapter, societies and economies involve

market and nonmarket interests of diverse stakeholders as well as stockholders. To understand and effect responsible corporate strategies, methods that include different players and environmental factors—not just stockholders or financial interests—are required. We also live in a post-Enron world. Some officers in corporations can engage in illegal and unethical practices with investors' funds and assets. Stakeholder theory addresses these realities. The following points also respond to some of the above criticisms. First, stakeholder theory does offer advantages; e.g., Heugens and Van Riel (2002) present evidence showing that stakeholder management may result in both organizational learning and societal legitimacy. Secondly, Key's (1999) stakeholder theory of the firm,<sup>16</sup> summarized by Mitchell, Agle, and Wood (1997),<sup>17</sup> states:

We argue that stakeholder theory must account for power and urgency as well as legitimacy, no matter how distasteful or unsettling the results. Managers must know about groups in their environment that hold power and intend to impose their will upon the firm. Power and urgency must be attended to if managers are to serve the legal and moral interests of legitimate stakeholders.

The ethical dimension of stakeholder theory is based on the view that profit maximization is constrained by justice, and that regard for individual rights should be extended to all constituencies that have a stake in a business, and that organizations are not only “economic” in nature, but can act in socially responsible ways. To this end, companies “should” act in socially responsible ways, not only because it's the “right thing to do,” but also to ensure their legitimacy.<sup>18</sup>

## 2.2 STAKEHOLDER MANAGEMENT APPROACH DEFINED

The *stakeholder management approach* is based on an instrumental theory that argues “a subset of ethical principles (trust, trustworthiness, and cooperativeness) can result in significant competitive advantage.”<sup>19</sup> At the same time, this approach includes analytical concepts and methods for identifying, mapping, and evaluating corporate strategy with stakeholders. We refer to these methods as “stakeholder analysis.” The stakeholder management approach, including frameworks for analyzing and evaluating a corporation's relationships (present and potential) with external groups, aims ideally at reaching “win-win” collaborative outcomes. Here, “win-win” means making moral decisions that benefit the common good of all constituencies within the constraints of justice, fairness, and economic interests. Unfortunately, this does not always happen. There are usually winners and losers in complex situations where there is a perceived zero-sum game (i.e., a situation in which there are limited resources, and what is gained by one person is necessarily lost by the other).

Scholars and consultants, however, have used the stakeholder management approach as a means for planning and implementing collaborative relationships to achieve win-win outcomes among stakeholders.<sup>20</sup>



Structured dialogue facilitated by consultants is a major focus in these collaborative communications. The aim in using the stakeholder approach as communication strategy is to change perceptions and “rules of engagement” to create win-win outcomes.

A stakeholder approach does not have to result from a crisis, as so many examples from ethics literature and the news provide. It can also be used as a planning method to anticipate and facilitate business decisions, events, and policy outcomes. A stakeholder analysis is also not limited to large enterprises. Business units, teams, and groups can use this approach.

A stakeholder management approach also begins, as indicated in Chapter 1, by asking what external forces in the general environment are affecting an organization. This context can often provide clues to responses by stakeholders to opportunities, crises, and extraordinary events. Corporate scandals revealed following the Enron debacle suggest that there were several factors in the general environment that were at play in addition to certain corporate executives’ greed. For example, the dot-com bubble created a financial environment where investment funds followed innovative ideas in exorbitant and exuberant ways. Investment banks loaned large amounts to Enron and other companies without due diligence. Stock analysts lied and encouraged deceptive investing from the public. Boards of directors abandoned their fiscal responsibilities, as did large accounting firms like Arthur Andersen, which is no longer in existence. The general legal and enforcement environment during the 1990s appeared indifferent to monitoring corporate activities and protecting shareholders. This all changed after Enron. Let’s define two major terms before explaining how to do a stakeholder analysis.

## Stakeholders

A *stakeholder* is “any individual or group who can affect or is affected by the actions, decisions, policies, practices, or goals of the organization.”<sup>21</sup> We begin by identifying the focal stakeholder. This is the company or group that is the focus of our analysis.

The primary stakeholders of a firm include its owners, customers, employees, and suppliers. Also of primary importance to a firm’s survival are its stockholders and board of directors. The CEO and other top-level executives can be stakeholders, but in the stakeholder analysis, they are generally considered actors and representatives of the firm. In the opening case, Mattell’s CEO and top-level team are focal stakeholders. Primary stakeholders include owners, customers, employees, and in this case Chinese vendors and suppliers.

*Secondary stakeholders* include all other interested groups, such as the media, consumers, lobbyists, courts, governments, competitors, the public, and society. Mattell outsources in part to outperform its competitors. Consumers may or may not gain an advantage from Mattell’s outsourcing, depending on the prices and quality of products. In the opening case consumers were at a disadvantage through impaired, even



dangerous, outsourced product quality. Outsourcing issues also occur in call centers. For example, Dell Computer, because of continuing complaints from corporate customers regarding language misunderstanding and low level service, announced on November 25, 2003, that it would direct calls for corporate customers only to call centers in Texas, Idaho, and Tennessee.<sup>22</sup>

## Stakes

A *stake* is any interest, share, or claim that a group or individual has in the outcome of a corporation's policies, procedures, or actions toward others. Stakes may be based on any type of interest. The stakes of stakeholders are not always obvious. The economic viability of competing firms can be at stake when one firm threatens entry into a market. The physical health of a community can be at stake when corporations like Mattell outsource manufacturing without quality control.

Stakes also can be present, past, or future oriented. For example, stakeholders may seek compensation for a firm's past actions, as occurred when lawyers argued that certain airlines owed their clients monetary compensation after having threatened their emotional stability when pilots announced an impending disaster (engine failure) that, subsequently, did not occur. Stakeholders may seek future claims; that is, they may seek injunctions against firms that announce plans to drill oil or build nuclear plants in designated areas or to market or bundle certain products in noncompetitive ways.

## 2.3 HOW TO EXECUTE A STAKEHOLDER ANALYSIS

The stakeholder analysis is a pragmatic way of identifying and understanding multiple (often competing) claims of many constituencies. As part of a general stakeholder approach, the stakeholder analysis is a method to help understand the relationships between an organization and the groups with which it must interact. Each situation is different and therefore requires a map to guide strategy for an organization dealing with groups, some of whom may not be supportive of issues such as outsourcing jobs. The aim here is to familiarize you with the framework so that you can apply it in the classroom and in news events that appear in the press and in other media. Even though you may not be an executive or manager, the framework can enable you to see and understand more clearly complex corporate dealings. Former students of mine who are now professional consultants, owners, and managers have reported that their having studied the stakeholder approach helped them see the "big picture" and clients differently in their careers. Although this chapter focuses on upper-level and functional area managers as stakeholders who formulate and direct corporate strategy, Chapter 3 discusses the individual employee and the organization as stakeholders. Chapter 3 also provides ethical principles you can use to evaluate the moral criteria of strategies used by managers when responding to different stakeholders.

## Taking a Third-Party Objective Observer Perspective

In the following discussion, you are asked to assume the role of a chief executive officer (CEO) of a company to execute a stakeholder analysis. However, it is recommended that you take the role of “third-party objective observer” when doing a stakeholder analysis. Why? In this role, you will need to suspend your belief and value judgments in order to understand the strategies, motives, and actions of the different stakeholders. You may not agree with the focal organization or CEO whom you are studying. Therefore, the point is to be able to see all sides of an issue and then objectively evaluate the claims, actions, and outcomes of all the parties. Being more objective helps determine who acted responsibly, who won and who lost, and at what costs.

Part of the learning process in this exercise is to see your own blind spots, values, beliefs, and passions toward certain issues and stakeholders. Doing an in-depth stakeholder analysis with a group enables others to see and comment on your reasoning. For the next section, however, take the role of a CEO so you can get an idea of what it feels like to be in charge of directing an organization-wide analysis.

## Role of the CEO in Stakeholder Analysis

Assume you are the CEO, working with your top managers, in a firm that has just been involved in a major controversy of international proportions. The media, some consumer groups, and several major customers have called you. You want to get a handle on the situation without reverting to unnecessary “firefighting” management methods. A couple of your trusted staff members have advised you to adopt a planning approach quickly while responding to immediate concerns and to understand the “who, what, where, when, and why” of the situation before jumping to “how” questions. Your senior strategic planner suggests you lead and participate in a stakeholder analysis. What is the next step?

The stakeholder analysis is a series of steps aimed at the following tasks:<sup>23</sup>

1. Map stakeholder relationships.
2. Map stakeholder coalitions.
3. Assess the nature of each stakeholder’s interest.
4. Assess the nature of each stakeholder’s power.
5. Construct a matrix of stakeholder moral responsibilities.
6. Develop specific strategies and tactics.
7. Monitor shifting coalitions.

Each step is described in the following sections. Let us explore each one and then apply them in our continuing scenario example.

**Step 1: Map Stakeholder Relationships** In 1984, R. Edward Freeman offered questions that help begin the analysis of identifying major stakeholders (Figure 2.1). The first five questions in the figure offer a quick jump-start on the analysis. Questions 6 through 9 may be used in later steps, when you assess the nature of each stakeholder’s interest and priorities.

● Figure 2.1

### Sample Questions for Stakeholder Review

1. Who are our stakeholders currently?
2. Who are our potential stakeholders?
3. How does each stakeholder affect us?
4. How do we affect each stakeholder?
5. For each division and business, who are the stakeholders?
6. What assumptions does our current strategy make about each important stakeholder (at each level)?
7. What are the current “environmental variables” that affect us and our stakeholders (initiation, GNP, prime rate, confidence in business [from polls], corporate identity, media image, and so on)?
8. How do we measure each of these variables and their impact on us and our stakeholders?
9. How do we keep score with our stakeholders?

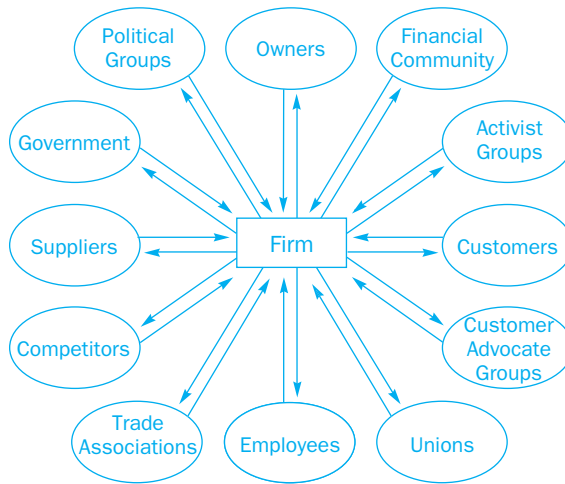
**SOURCE:** R. Edward Freeman. 1984. *Strategic Management: A Stakeholder Approach*. Boston: Pitman, 242. Reproduced with permission of the author.

Let's continue our example with you as CEO. While brainstorming about questions 1 through 5 with employees you have selected who are the most knowledgeable, current, and close to the sources of the issues at hand, you may want to draw a stakeholder map and fill in the blanks. Note that your stakeholder analysis is only as valid and reliable as the sources and processes you use to obtain your information. As more controversial, incomplete, or questionable issues arise, you may wish to go outside your immediate planning group to obtain additional information and perspective. A general picture of an initial stakeholder map is shown in Figure 2.2 on the next page. The reciprocal arrows in this figure represent enacted major strategies and tactics between each stakeholder and the focal stakeholder. You would identify and complete the stakeholder map, inserting each relevant stakeholder involved in the particular issue you are studying. For example, if you were examining Mattel's recalls, you would place the Mattel Inc. corporation in the center (or focal) stakeholder box, then continue identifying the other groups involved with that issue: e.g., Management (Dick Eckert, CEO; Thomas Dibrowski, EVP), Employees, Shareholders (members of the lawsuit), Victims (children, their families), Chinese government (Chanjiang Product Safety), Chinese manufacturers (Early Light Industrial Company), U.S. government (George W. Bush; Dick Durbin, Senator), Suppliers and distributors (Wal-Mart, Target, Toys “R” Us), Competitors (Hasbro), and others.

**Step 2: Map Stakeholder Coalitions** After you identify and make a map of the stakeholders who are involved with your firm in the incident you are addressing, the next step is to determine and map any coalitions that have formed. Coalitions among stakeholders form around stakes that they have—or seek to have—in common. Interest groups and lobbyists sometimes join forces against a common “enemy.” Competitors also may join forces

Figure 2.2

## Stakeholder Map of a Large Organization



**SOURCE:** R. Edward Freeman. 1984. *Strategic Management: A Stakeholder Approach*. Boston: Pitman, 25. Reproduced with permission of the author.

if they see an advantage in numbers. Mapping actual and potential coalitions around issues can help you, as the CEO, anticipate and design strategic responses toward these groups before or after they form.

**Step 3: Assess the Nature of Each Stakeholder's Interest** Steps 3 and 4, which assess the nature of each stakeholder's power, overlap to some extent. Figure 2.4, on page 50, is explained in more detail in step 6, but observe in that figure the four different types of stakeholders you face as a company—the “supportive,” “nonsupportive,” “mixed blessing,” and “marginal.” The supportive and nonsupportive are with and against you. With the “mixed blessing” and “marginal,” you are less sure about their support for your strategy. Briefly identify each of these groups' interests or stakes with regard, for example, to your outsourcing practice and strategy—as if you were Mattel.

In the opening Mattel example, if you had been the CEO, along with his staff, you might determine that supporters of Mattel's plans would be many employees, management, and Mattel's lawyers. Their interests are to make a profit and see that you do. Nonsupportive stakeholders, or those who may seek to prevent, disrupt, and/or attack Mattel's outsourcing strategies, may include some shareholders and their lawyers, the Chinese government, members of the U.S. government, the victims and their families, consumers, competitors, and the media. The interests of these stakeholders vary: victims may demand compensation for any harm done; shareholders wish to protect their investments; U.S. Congress members want to protect citizens from harm and safeguard their own reputations for acting on behalf of their constituents; consumers want assurance that their children are not at risk; media representatives want stories and information that inform and sell.

Who else would you add to those in opposition to Mattel? By systematically completing this audit through brainstorming, you, as a CEO in crisis, can create a broader, more objective picture of the situation, the players and their interests, and your firm's role in the situation.

**Step 4: Assess the Nature of Each Stakeholder's Power** This part of the analysis asks, "What's in it for each stakeholder? Who stands to win, lose, or draw over certain stakes?" Eight types of power that different stakeholders exert and which you can use in your analysis include: (1) *voting power* (the ability of stakeholders to exert control through strength in numbers); (2) *political power* (the ability to influence decision making processes and agendas of public and private organizations and institutions); (3) *economic power* (the ability to influence by control over resources—monetary and physical); (4) *technological power* (the ability to influence innovations and decisions through uses of technology); (5) *legal power* (the ability to influence laws, policies, and procedures); (6) *environmental power* (the ability to impact nature); (7) *cultural power* (the ability to influence values, norms, and habits of people and organizations); and (8) *power over individuals and groups* (the ability to influence particular, targeted persons and groups through different forms of persuasion).<sup>24</sup> The Mattel example suggests that shareholders, members of Congress, and individual constituents have voting power over Mattel's policies, and officers' jobs and responsibilities. Chinese contractors and government representatives exert economic power over Mattel's expenses and profits. The U.S. government also exerts political power over Mattel's operating and manufacturing policies and processes.

Note that power and influence are exerted in two-way relations: Mattel toward its stakeholders, and each stakeholder toward Mattel on a given issue. For example, owners and stockholders can vote on the firm's decisions regarding a particular issue or opportunity, such as Mattel's policies with Chinese and international contractors. On the other hand, federal, state, and local governments can exercise their political power by voting on Mattel's legal obligations toward consumers. New legislation may emerge with regard to the regulation of Mattel's outsourcing and quality control methods. In return, consumers can exercise their economic power by boycotting Mattel's products or buying from other companies. The Chinese government can react to Mattel by asserting that it was Mattel's responsibility to inform Chinese subcontractors about U.S. quality standards. What other sources of stakeholder power exist in this case?

**Step 5: Identify Stakeholder Ethics and Moral Responsibilities** After you map stakeholder relationships and assess the nature of each stakeholder's interest and power, the next step is to determine the responsibilities and moral obligations your company has to each stakeholder. A matrix of stakeholder responsibilities is shown in Figure 2.3. For example, Mattel's CEO may see the firm's *economic responsibility* to the owners (as stakeholders) as "preventing as many costly lawsuits as possible." *Legally*, the CEO may want to protect the owners and the executive team from liability and damage; this would entail proactively negotiating disputes outside the courts, if possible, in a way that is equitable to all. *Ethically*, the CEO may keep the company's stockholders and owners current regarding his or her ethical thinking and

Figure 2.3

**Stakeholder Moral Responsibility Matrix**

		Nature of Focal Company Responsibilities			
		Legal	Economic	Ethical	Voluntary
Stakeholders	Owners				
	Customers				
	Employees				
	Community interest groups				
	Public (citizens at large)				

strategies to show responsibility toward all stakeholders. At stake is the firm's reputation as well as its profitability. Chapter 3 explains ethical principles and guidelines that can assist in this type of decision making. For purposes of completing this matrix, ethical decision making of company representatives can refer to the following ethical principles: *utilitarianism* (weighing costs and benefits; “ends justifying means”), *universalism* (showing respect and concern for human beings; “means count as much as ends”), *rights* (recognizing individual liberties and privileges under laws and constitutions), *justice* (observing the distribution of burdens and benefits of all concerned). *Voluntarily*, (i.e., acting freely and from one's own accord), the CEO may advise shareholders to show responsibility by publicly announcing their plans for resolving the accusations about the firm's “next steps” in more open and conscientious marketing and distribution of products.

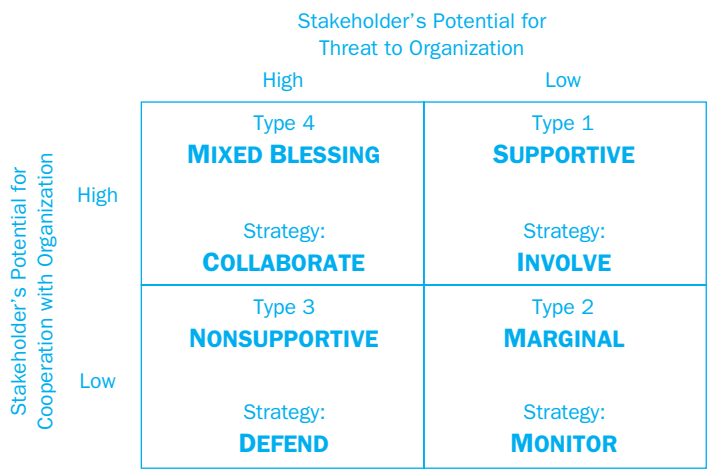
This part of the analysis can help you identify economic, legal, ethical, and voluntary responsibilities for each group of stakeholders, so that you can develop strategies toward each stakeholder you have identified.

**Step 6: Develop Specific Strategies and Tactics** Using your results from the preceding steps, you can now proceed to outline the specific strategies and tactics you wish to use with each stakeholder.

First, you should consider whether to approach each stakeholder directly or indirectly. Second, you need to decide whether to do nothing, monitor, or take an offensive or defensive position. Third, you can determine whether to accommodate, negotiate, manipulate, resist, avoid, or “wait and see.” Finally, you can decide what combination of strategies you want to employ to achieve your goal.

Figure 2.4

Diagnostic Typology of Organizational Stakeholders



**SOURCE:** Academy of Management Executive: *The Thinking Manager's Source*, by G. Savage et al. Copyright 1991 by Academy of Management. Reproduced with permission of Academy of Management in the format Textbook via Copyright Clearance Center.

A useful typology for both identifying and deciding on strategies to employ in a complex situation is shown in Figure 2.4.<sup>25</sup> This diagnostic typology of organizational stakeholders shows two dimensions: potential for threat and potential for cooperation. Note that stakeholders can move among the quadrants, changing positions as situations and stakes change.

The ideal strategic situation for the focal corporation is type 1, the *supportive* stakeholder with a low potential for threat and high potential for cooperation. Here the strategy of the focal company is to *involve* the supportive stakeholder. Think of both internal and external stakeholders who might be supportive and who should be involved in the focal organization's strategy.

In contrast, there is type 3, the *nonsupportive* stakeholder who shows a high potential for threat and a low potential for cooperation. The suggested strategy in this situation calls for the focal organization to *defend* its interests and reduce dependence on that stakeholder.

A type 4 stakeholder is a *mixed blessing*, with a high potential for both threat and cooperation. This stakeholder calls for a *collaborative* strategy. In this situation, the stakeholder could become supportive or nonsupportive. Collaborative attempts to move the stakeholder to the focal company's interests is the goal.

Finally, type 2 is the *marginal* stakeholder. This stakeholder has a low potential for both threat and cooperation. Such stakeholders may not be interested in the issues of concern. The recommended strategy in this situation is to *monitor* the stakeholder, to "wait and see" and minimize expenditure of resources, until the stakeholder moves to a mixed blessing, supportive, or nonsupportive position.

Figure 2.5

**Diagnostic Typology of Stakeholders for Mattell Corporation**

<p>Type 2 <b>MIXED BLESSING</b></p> <ul style="list-style-type: none"> <li>• Chinese manufacturers</li> <li>• Civil liberty groups</li> </ul>	<p>Type 1 <b>SUPPORTIVE</b></p> <ul style="list-style-type: none"> <li>• Mattell's CEO are top level team</li> <li>• Many employees</li> <li>• Many share holders</li> </ul>
<p>Type 3 <b>NONSUPPORTIVE</b></p> <ul style="list-style-type: none"> <li>• Victims who lost jobs</li> <li>• Customers negatively affected by toys</li> <li>• Some competitors</li> <li>• Some U.S. Congress persons</li> <li>• Employees negatively affected</li> </ul>	<p>Type 4 <b>MARGINAL</b></p> <ul style="list-style-type: none"> <li>• Some shareholders</li> <li>• Some customers</li> <li>• Some suppliers</li> </ul>

Figure 2.5 presents an illustration of the typology in Figure 2.4, using the Mattel recall opening case as an example. Indicate other stakeholders who might be or were influenced by Mattel's decision to outsource and recall products. Using your objective "third-party perspective," determine the movement among stakeholder positions: Who influenced whom, by what means, and how? Using arrows on this diagram, suggest who might move from one quadrant to another. As you look at Figure 2.5, ask yourself: Do I agree with this diagram as it is completed? Who is likely to move from Supportive to Nonsupportive? From a Mixed Blessing position to Nonsupportive or Supportive? Why? How? Support your logic and defend your position.

From the point of view of the focal stakeholder, while you as CEO are developing specific strategies, keep the following points in mind:

1. Your goal is to create a win-win set of outcomes, if possible. However, this may mean economic costs to your firm if, in fact, members of your firm are responsible to certain groups for harm caused as a consequence of your actions.
2. Ask: "What is our business? Who are our customers? What are our responsibilities to the stakeholders, to the public, and to the firm?" Keep your mission and responsibilities in mind as you move forward.
3. Consider the probable consequences of your actions. For whom? At what costs? Over what period? Ask: "What does a win-win situation look like for us?"
4. Keep in mind that the means you use can be important as the ends you seek; that is, how you approach and treat each stakeholder can be as important as what you do.



Specific strategies now can be articulated and assigned to corporate staff for review and implementation. Remember, social responsibility is a key variable; it is as important as the economic and political factors of a decision because social responsibility is linked to costs and benefits in other areas. At this point, you can ask to what extent your strategies are just and fair and consider the welfare of the stakeholders affected by your decision.

Executives use a range of strategies, especially in long-term crisis situations, to respond to external threats and stakeholders. Their strategies often are short-sighted and begin as a defensive move. When observing and using a stakeholder analysis, question why executives respond to their stakeholders as they do. Following the questions and methods in this chapter systematically helps you understand why key stakeholders respond as they do.

**Step 7: Monitor Shifting Coalitions** Because time and events can change the stakes and stakeholders, and their strategies, you need to monitor the evolution of the issues and actions of the stakeholders, using Figure 2.4. Tracking external trends and events and the resultant stakeholder strategies can help a CEO and his or her team act and react accordingly. This is a dynamic process that occurs over time and is affected by strategies and actions that you, as CEO, and your team direct with each stakeholder group as events occur. Your decisions are influenced by how effective certain stakeholders respond (or counteract) you and your team's strategies and actions. As CEO, you would typically follow a utilitarian ethic of weighing costs and benefits of all your strategies and actions toward each major stakeholder group, keeping your company's best interests in mind. However, neglecting the public, common good of all your stakeholders also affects your "bottom line." If you followed a universalistic ethic in the Mattel case, you might attempt to provide care for each child who was harmed as well as those who may have been at risk with your manufactured toys. You would have taken immediate action to recall toys manufactured in China, and then have planned meetings with those in charge of the subcontractors and with some of the victims' families, the media, and powerful government representatives to show concern, and protect the company's image and reputation going forward. Ethics is—should be—an integral part of every corporation's and organization's goals, objectives, strategies, and actions that affect other people. A question in the stakeholder analysis offered here is, What ethical principle(s)—if any—did the CEO you are studying follow, and why, given the pressures from different stakeholders?

## Summary of Stakeholder Analysis

You have now completed the basic stakeholder analysis and should be able to proceed with strategy implementation in more realistic, thoughtful, interactive, and responsible ways. The stakeholder approach should involve other decision makers inside and outside the focal organization.

The stakeholder analysis provides a rational, systematic basis for understanding issues and the “ethics in action” involved in complex relationships between an organization, its leaders, and constituents. It helps decision makers structure strategic planning sessions and decide how to meet the moral obligations of all stakeholders. The extent to which the resultant strategies and outcomes are moral and effective for a firm and its stakeholders depends on many factors, including the values of the firm’s leaders, the stakeholders’ power, the legitimacy of the actions, the use of available resources, and the exigencies of the changing environment.

## 2.4 NEGOTIATION METHODS: RESOLVING STAKEHOLDER DISPUTES

Disputes are part of stakeholder relationships. Most disputes are handled in the context of mutual trusting relationships between stakeholders; others move into the legal and regulatory system.<sup>26</sup> Disputes occur between different stakeholder levels: for example, between professionals within an organization, consumers and companies, business to business (B2B), governments and businesses, and among coalitions and businesses. It is estimated that Fortune 500 senior HR executives are involved in legal disputes 20% of their working time. Also, managers generally spend 30% of their time handling conflicts. The hidden cost of managing conflicts between and among professionals in organizations can result in absenteeism, turnover, legal costs, and loss of productivity.<sup>27</sup> It is estimated that U.S. retail e-commerce sales, not including travel, will reach \$146 billion in 2008, up 14.3% over 2007. With that volume, there will be business disputes. A study by the American Arbitration Association found that:

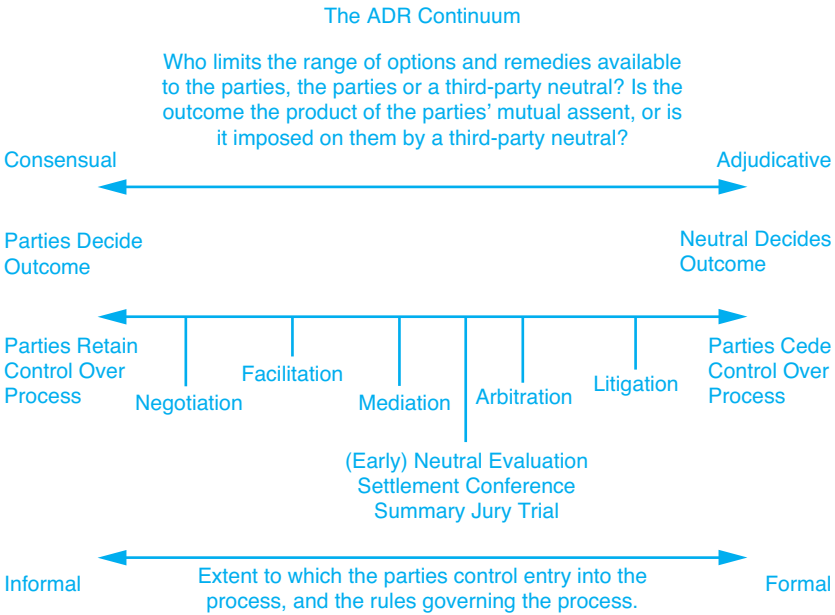
1. 58% of companies have no plans in place to handle B2B eCommerce disputes.
2. Seven out of ten executives and general counsel state that additional guidelines are required to handle online disputes.
3. Only 41% of companies have guidelines for conducting B2B eCommerce relationships.
4. Most executives surveyed said that placing supply chains online creates different and new types of disputes.<sup>28</sup> Stakeholder conflict and dispute resolution methods are necessary.

### Stakeholder Dispute Resolution Methods

Dispute resolution is an expertise also known as “alternative dispute resolution” (ADR). Dispute resolution techniques cover a variety of methods intended to help potential litigants resolve conflicts. The methods can be viewed on a continuum ranging from face-to-face negotiation to litigation, as Figure 2.6 illustrates. Advocates of alternative resolution methods argue that litigation need not be the standard for evaluating

Figure 2.6

The ADR Continuum



other dispute techniques.<sup>29</sup> Figure 2.6 illustrates the degree to which disputing parties give up control of the process and outcome to a neutral third party.

The left side of the continuum is based on consensual, informal dispute resolution methods. Negotiating, facilitation, and some mediation are methods where the parties maintain control over the conflict resolution process. Moving to the right side of the spectrum (adjudicative), disputing parties give up control to third-party arbitrators and then litigators (courts, tribunals, and binding arbitration). For example, with regard to outsourcing issues discussed earlier in the chapter, most companies have the authority to make outsourcing decisions. However, with regard to outsourcing control over who and what types of contracts will be used to, for example, rebuild Iraq, Congress is debating the use of external contractors for doing federal work. Halliburton received several exclusive outsourced contracts in this effort. Congress is using the fiscal 2005 defense authorization bill to enable civil service employees in the Departments of Defense and Homeland Security, the Internal Revenue Service, and the Pentagon to control the use of external contractors. Although Republican and Democratic senators debate this issue, some argue that private company bidders have appeal rights.<sup>30</sup>

The stakeholder management approach involves the full range of dispute resolution techniques, although ideally more *integrative* and *relational* rather than *distributive* or *power-based* methods would be attempted first.

(Power-based approaches are based on authoritarian and competition-based methods where the more powerful group or individual “wins” and the opposing group “loses.” This approach can cause other disputes to arise.) Integrative approaches are characterized as follows:

- Problems are seen as having more potential solutions than are immediately obvious.
- Resources are seen as expandable; the goal is to “expand the pie” before dividing it.
- Parties attempting to create more potential solutions and processes are thus said to be “value creating.”
- Parties attempt to accommodate as many interests of each of the parties as possible.
- The so-called “win-win” or “all gain” approach.<sup>31</sup>

Distributive approaches have the following characteristics:

- Problems are seen as “zero sum.”
- Resources are imagined as fixed: “divide the pie.”
- “Value claiming.”
- Hagglng or “splitting the difference.”<sup>32</sup>

Relational approaches (which consider power, interests, rights, and ethics) include and are based on:

- “Relationship building.”
- “Narrative,” “deliberative,” and other “dialogical” (i.e., dialogue-based) approaches to negotiation and mediation.
- Restorative justice and reconciliation (i.e., approaches that respect the dignity of every person, build understanding, and provide opportunities for victims to obtain restoration and for offenders to take responsibility for their actions).
- Other “transformative” approaches to peacebuilding.<sup>33</sup>

The process of principled negotiation from Roger Fry and William Ury’s book, *Getting to Yes*, continues to be used for almost any type of dispute. The four principles include:

1. Separate the people from the problem.
2. Focus on interests rather than positions.
3. Generate a variety of options before settling on an agreement.
4. Insist that the agreement be based on objective criteria.<sup>34</sup>

Adjudicative, legislative, restorative justice, reparation, and rights-based approaches are necessary when rights, property, or other legitimate claims have been violated and harm results. Leaders and professionals practicing a stakeholder management approach incorporate and gain proficiency in using a wide range of conflict and alternative dispute resolution methods.<sup>35</sup>

## 2.5 STAKEHOLDER APPROACH AND ETHICAL REASONING

Ethical reasoning in the stakeholder analysis involves asking: “What is equitable, just, fair, and good for those who affect and are affected by business decisions? Who are the weaker stakeholders in terms of power and influence? Who can, who will, and who should help weaker stakeholders make their voices heard and encourage their participation in the decision process?” Finally, the stakeholder analysis requires the principal stakeholders to define and fulfill their ethical obligations to the affected constituencies.

Chapter 3 explains major ethical principles that can be used to examine individual motivation for resolving an ethical dilemma. That chapter explains several ethical frameworks and principles, including the following: (1) the common good principle, (2) rights, (3) justice, (4) utilitarianism, (5) relativism, and (6) universalism, all of which can be applied to belief systems, policies, and motives. You may want to refer to Chapters 2 and 3 when using ethical principles to describe actual individuals’ and groups’ observed moral policies, motives, and outcomes in cases that you are studying or creating from your experience or research.

## 2.6 MORAL RESPONSIBILITIES OF CROSS-FUNCTIONAL AREA PROFESSIONALS

One goal of a stakeholder analysis is to encourage and prepare organizational managers to articulate their own moral responsibilities, as well as the responsibilities of their company and their profession, toward their different constituencies. Stakeholder analysis focuses the enterprise’s attention and moral decision making process on external events. The stakeholder approach also applies internally, especially to individual managers in traditional functional areas. These managers can be seen as conduits through which other external stakeholders are influenced.

Because our concern is managing moral responsibility in organizational stakeholder relationships, this section briefly outlines some of the responsibilities of selected functional area managers. With the Internet, the transparency of all organizational actors and internal stakeholders increases the risk and stakes of unethical practices. Chat rooms, message boards, and breaking news sites provide instant platforms for exposing both rumor and accurate news about companies. (In the tobacco controversy, it was an anti-smoking researcher and advocate who first posted inside information from a whistle-blower on the Internet. This action was a first step toward opening the tobacco companies’ internal documents to public scrutiny and the resulting lawsuits.)

Figure 2.7 illustrates a manager’s stakeholders. The particular functional area you are interested in can be kept in mind while you read the descriptions discussed next. Note that the same procedures, steps 1 through 7, presented in the stakeholder analysis, can also be used for this level of analysis.

Functional and expert areas include marketing, R&D, manufacturing, public relations, human resource management (HRM), and accounting

Figure 2.7

## A Manager's Stakeholders



**SOURCE:** R. Edward Freeman. 1984. *Strategic Management: A Stakeholder Approach*. Boston: Pitman, 218. Reproduced with permission of the author.

**NOTE:** The letters K, L, M, and N are hypothetical designations in place of real department names. Dotted lines refer to hypothetical linkages.

and finance. The basic moral dimensions of each of these are discussed. Even though functional areas are often blurred in some emerging network organizational structures and self-designed teams, many of the responsibilities of these managerial areas remain intact. Understanding these managerial roles from a stakeholder perspective helps to clarify the pressures and moral responsibilities of these job positions. This section can be read and revisited after reading Chapter 3, which presents ethical principles and quick ethical tests for professionals.

## Marketing and Sales Professionals and Managers as Stakeholders

Sales professionals and managers are continuously engaged—electronically and/or face-to-face—with customers, suppliers, and vendors. Sales professionals are also evaluated by quotas and quantitative expectations on a weekly, monthly, and quarterly basis. The stress and pressure to meet expectations is always present. Sales professionals must continually balance their personal ethics and their professional pressures. The dilemma often becomes: “Who do I represent? What weight do my beliefs and ethics have when measured against my department’s and company’s performance measures for me?” Another key question for sales professionals particularly is: “Where is the line between unethical and ethical practices for me?”

Also, because customers are an integral part of business, these professionals must create and maintain customer interest and loyalty. They must be concerned with consumer safety and welfare, while increasing revenue and obtaining new accounts. Many marketing and sales professionals also are responsible for determining and managing the firm's advertising and the truthfulness (and legality) of the data and information they issue to the public about products and services. They must interact with many of the other functional areas and with advertising agencies, customers, and consumer groups. Moral dilemmas can arise for marketing managers who may be asked to promote unsafe products or to implement advertising campaigns that are untrue or not in the consumer's best interests.

Several equity traders, particularly at Enron, during and after the corporate scandals were involved in lying to customers about "dogs"—stocks which they knew were underperforming. Part of their motive was to keep certain stocks popular and in a "buy" mode so their own sales performance would be valued higher, giving them better bonuses.

A major moral dilemma for marketing managers is having to choose between a profitable decision and a socially responsible one. The stakeholder analysis helps marketing managers in these morally questionable situations by identifying stakeholders and understanding the effects and consequences of profits and services on them. Balancing company profitability with human rights and interests is a moral responsibility of marketers. Companies that have no ethics code or socially responsible policies—as well as those that do have these, but do not enforce them—increase the personal pressure, pain, and liability of individual professionals. Such tensions can lead to unethical and illegal activities.

## **R&D, Engineering Professionals, and Managers as Stakeholders**

R&D managers and engineers are responsible for the safety and reliability of product design. Faulty products can mean public outcry, which can result in unwanted media exposure and possibly (perhaps justifiably) lawsuits. R&D managers must work and communicate effectively and conscientiously with professionals in manufacturing, marketing, and information systems; senior managers; contractors; and government representatives, to name a few of their stakeholders. The Mattel opening case illustrates that product design and quality control for toy products involve more stakeholders than the company officers probably envisioned before that crisis erupted. Technical issues can quickly escalate to political, cultural, legislative and judicial levels; ethical issues that may begin as professional ethical codes of engineers can, if a product crisis occurs, transform into legal concerns about international human and consumer rights and justice. As studies and reports on the classic Challenger space shuttle disaster illustrate, engineers and managers at the National Aeronautics and Space Administration (NASA) and the co-operating company, Thiokol, had different priorities, perceptions, and technical judgments regarding the "go, no-go" decision of that space launch. Lack of individual responsibility and critical judgment contributed to the miscommunication and resulting disaster.

Moral dilemmas can arise for R&D engineers whose technical judgments and risk assessments conflict with administrative managers seeking profit and time-to-market deadlines. R&D managers also can benefit from doing a stakeholder analysis, before disasters like the failed Challenger launch occur. The discussion of the “levels of business ethics” in Chapter 1 also provides professionals with a way of examining their individual ethics and moral responsibilities.

## **Accounting and Finance Professionals and Managers as Stakeholders**

Accounting and finance professionals are responsible for the welfare of clients by safeguarding their financial interests. Financial planners, brokers, accountants, mutual fund managers, bankers, valuation specialists, and insurance agents have the responsibility of ensuring reliable and accurate transactions and reporting of other people’s money and assets.<sup>36</sup> Many of these professions are part of regulated industries; however, the corporate scandals at Enron, Tyco, Arthur Anderson, and other large firms showed that company culture, individual and team judgment, greed, and lack of integrity contributed to executives’ “cooking the books.” Financial fraud, stealing, gambling away employees’ pensions, and shareholders’ investments were part of the illegal activities officers of these firms directed and led. While the Sarbanes-Oxley Act, the Revised Sentencing Guidelines, and stricter company ethics and reporting codes (see Chapter 4) have helped prevent illegal activity in these professions, problems remain.

Factors in these professions that trigger unethical activities include: (1) pressures from senior officers and supervisors to “maximize profits,” sometimes at any costs; (2) lack of integrity (truthfulness, conscience) of leaders, supervisors, and employees; (3) corporate cultures that devalue clients, investors, and employees; (4) requests from clients to change financial statements, tax returns and commit tax fraud; (5) conflict of interest and lack of auditor independence between client and auditing firm; and (6) blurring professional and personal roles and responsibilities between client and professional. These issues are in part related to societal, structural problems. For example, the U.S. financial system emphasizes and rewards short-term, quarterly earnings that help create many of the pressures and poor practices listed above. Chapters 4 and 5 also deal with these topics in more detail.

## **Public Relations Managers as Stakeholders**

Public relations (PR) managers must constantly interact with outside groups and corporate executives, especially in an age when communications media, external relations, and public scrutiny play such vital roles. PR managers are responsible for transmitting, receiving, and interpreting information about employees, products, services, and the company. A firm’s public credibility, image, and reputation depend on how PR professionals manage stakeholders because PR personnel must often negotiate the boundaries between corporate loyalty and credibility with external groups. These groups often use different criteria than corporate executives do for measuring success and



responsibility, especially during crises. Moral dilemmas can arise when PR managers must defend company actions that have possible or known harmful effects on the public or stakeholders. A stakeholder analysis can prepare PR managers and inform them about the situation, the stakes, and the strategies they must address.

## Human Resource Managers as Stakeholders

Human resource managers (HRMs) are on the front line of helping other managers recruit, hire, fire, promote, evaluate, reward, discipline, transfer, and counsel employees. They negotiate union settlements and assist the government with enforcing Equal Employment Opportunity Commission (EEOC) standards. Human resource management professionals must translate employee rights and laws into practice. They also research, write, and maintain company policies on employee affairs. They face constant ethical pressures and uncertainties over issues about invasion of privacy and violations of employees' rights. Stakeholders of HRMs include employees, other managers and bosses, unions, community groups, government officials, lobbyists, and competitors.

Moral dilemmas can arise for these managers when affirmative action policies are threatened in favor of corporate decisions to hide biases or protect profits. HRMs also straddle the fine line between the individual rights of employees and corporate self-interests, especially when reductions in force (RIFs) and other hiring or firing decisions are involved. As industries restructure, merge, downsize, outsource, and expand internationally, the HRMs' work becomes even more complicated.

## Summary of Managerial Moral Responsibilities

Expert and functional area managers are confronted with balancing operational profit goals with corporate moral obligations toward stakeholders. These pressures are considered "part of the job." Unfortunately, clear corporate directions for resolving dilemmas that involve conflicts between individuals' rights and corporate economic interests generally are not available. Using a stakeholder analysis is "like walking in the shoes of another professional." You get a sense of his or her pressures. Using a stakeholder analysis is a step toward clarifying the issues involved in resolving ethical dilemmas. Chapter 3 presents moral decision-making principles that can help individuals think through these issues and take responsible action.

## 2.7 ISSUES MANAGEMENT, STAKEHOLDER APPROACH, AND ETHICS: INTEGRATING FRAMEWORKS

Issues management methods complement the stakeholder management approach. It may be helpful to begin by identifying and analyzing major issues before doing a stakeholder analysis. Many reputable large companies use issues managers and methods for identifying, tracking, and responding to trends that offer potential opportunities, as well as threats to companies.<sup>37</sup>

Before discussing ways of integrating stakeholder management (and analysis) to issues management, issues management is defined.

### What Is a Public “Issue”?

An issue is a problem, contention, or argument that concerns both an organization and one or more of its stakeholders and/or stockholders. Also, “Think of an issue as a gap between your actions and stakeholder expectations. Second, think of issue management as the process used to close that gap.”<sup>38</sup> The gap can be closed in a number of ways, using several strategies. A primary method is using an accommodating policy. Providing public education, community dialogue, and changing expectations through communication are some accommodating strategies used in issues management. Solving complicated issues may sometimes require radical actions, like replacing members from the board of directors and the senior management team.<sup>39</sup>

Issues management is also a formal process used to anticipate and take appropriate action to respond to emerging trends, concerns, or issues that can affect an organization and its stakeholders.

Issues management is a . . . genuine and ethical long-term commitment by the organization to a two-way, inclusive standard of corporate responsibility toward stakeholders. Issues management involves connectivity with, rather than control of, others. Issues managers help identify and close gaps between expectation, performance, communication, and accountability. Issues management blends “many faces” within the entity into “one voice.” Like the issues themselves, the process is multi-faceted and is enhanced by the strategic facilitation and integration of diverse viewpoints and skills.<sup>40</sup>

Many national and international business-related controversies develop around the exposure of a single issue that evolves into more serious and costly issues. Enron’s problems in the beginning surfaced as an issue of overstated revenue. After months of investigation, members of the highest executive team were found to have been involved in deception, fraud, and theft. Mattel’s issue started as a question of a defective product that contained lead. While the company took some responsible steps, the CEO did not assume full and complete responsibility with Chinese contractors from the start. The issue, as noted earlier, escalated into other issues regarding managerial responsibility, cross-cultural coordination of quality control, the ethics of Mattel’s leadership, and perhaps the reputation of that company. Shareholders did file a lawsuit with management. Mattel is one of many firms that have and continue to face defective products. Ford Explorer had the Bridgestone/Firestone tire crisis with what appeared to be faulty tires. The issue escalated to questions about the design of the Ford vehicle itself, then to questions about many international deaths and accidents over a number of years. The CEO of Ford eventually lost his job.

### Other Public Issues

There are other types of public issues from the external environment that involve different companies and industries. For example, the issue of obesity has become prominent in the United States. Once considered a personal lifestyle problem, obesity is now seen as a public health disease, with

its treatment to be paid for by one's health insurance. This issue involves insurance companies, the corporations who employ individuals facing this problem, employment attorneys, families of those individuals affected, and taxpayers, to name a few. Another public issue that affects numerous stakeholders is drivers who drink. U.S. mothers who have lost their children to this growing phenomenon have discovered that this issue is not a set of isolated events, but widespread. MADD (Mothers Against Drunk Driving) was founded in the 1980s by Candy Lightner, whose 13-year-old daughter, Cari, was killed by a drunken hit-and-run driver as she walked down a suburban street in California. The impact broke almost every bone in her body and fractured her skull, and she died at the scene of the accident. "I promised myself on the day of Cari's death that I would fight to make this needless homicide count for something positive in the years ahead," Candy Lightner later wrote.<sup>41</sup>

Programs like *60 Minutes*, *Dateline*, *Frontline*, and PBS' (Public Broadcasting Station) *NOW* introduce breaking news that focuses on events, crises, and innovative practices that are being faced and addressed. Stakeholder and issues management frameworks can be used to understand the evolution of these issues in order to responsibly manage or change their effects.

## Stakeholder and Issues Management: "Connecting the Dots"

Issues and stakeholder management are used interchangeably by scholars and corporate practitioners, as the two following quotes illustrate:

For many societal predicaments, stakeholders and issues represent two complementary sides of the same coin.<sup>42</sup>

Stakeholders tend to organize around "hot" issues, and issues are typically associated with certain vocal stakeholder groups. Issues management scholars can therefore explore how issues management requires stakeholder prioritization, and how stakeholder management gets facilitated when managers have deep knowledge of stakeholders' issue agendas. Earlier research also suggests that whether or not stakeholders decide to get involved with certain issues has a profound influence on issue evolution, and as does the timing and extent of their involvement.<sup>43</sup>

Applying stakeholder and issues management approaches should not be mechanical. Moral creativity and objectivity help, as discussed in Chapter 1. A general first step is to ask, "What is the issue, opportunity, or precipitating event that an organization is facing or has experienced? How did the issue emerge?" Generally there are several issues that are discovered. A process begins by analyzing and then framing which issues are the most urgent and have (or may have) the greatest impact on the organization. At this point, you can begin to ask who was involved in starting or addressing the issue. This triggers the beginning of a stakeholder analysis and the steps discussed earlier in the chapter. Depending on how the issue evolved into other issues—or whether there was a crisis at the beginning, middle, or end of the issue evolution—you will know which issues management framework from the following section is most relevant to analyze the situation.

Actually, stakeholder analysis questions help “connect the dots” in understanding and closing the gaps of issues management. Why? Stakeholder questions help discover the “who did what to whom to influence which results, and at what costs and outcomes.” A major purpose in analyzing and effectively managing issues and stakeholders is to create environments that enable high-performing people to achieve productive and ethical results.

## Moral Dimensions of Stakeholder and Issues Management

Some studies argue that moral reasoning is “issue-dependent,” that “people generally behave better when the moral issue is important.”<sup>44</sup> Questions regarding issue recognition include: To what extent do people actually recognize moral issues? Is it by the magnitude of the potential consequences or the actual consequences of the issue? Is it by the social consensus regarding how important the issue is? Is it by how likely it is that the effects of the issue will be felt or how quickly the issue will occur?<sup>45</sup> Ethical reasoning and behavior are an important part of managing stakeholders and issues because ethics is the energy that motivates people to respond to issues. When ethical motives are absent from leaders’ and professionals’ thinking and feeling, activities can occur that cost all stakeholders. Learning to detect and prevent unethical and illegal actions by using these methods is an aim of this section.

Companies face issues every day. Some issues lead to serious consequences—defective products, financial fraud, fatal side effects of drugs, oil spills, the loss of millions of lives to the effects of tobacco, violence from use of firearms, or the theft of pensions from ordinary employees who worked a lifetime to accrue them. Other issues evolve in a way that leads to spectacular outcomes: the invention and commercialization of the Internet, information technology that provides wireless access to anyone at any time in any place, and the capability to network customers, businesses, suppliers, and vendors. Learning to identify and change issues for the good of the organization and for the common and public good is another goal of the stakeholder management approach.

## Introduction to Issues Management: Two Frameworks

This section presents two general issues frameworks for mapping and managing issues before and after they possibly evolve or erupt into crises. These frameworks can be used with the stakeholder management approach. Using a stakeholder analysis (which is part of the general stakeholder management approach) explains the “who, what, where, why, and what happened” that affects an issue. After you have read these first two issues management approaches shown in Figures 2.8 and 2.9, you will see from the different situations which framework is relevant.

Figure 2.8 illustrates a straightforward framework that organizations can use for anticipating and thinking through issues to prevent a crisis. The steps can also be used to plan and manage issues that may have

Figure 2.8

**Six-Step Issue Management Process**



already affected an organization. Senior officers and staff would probably use this framework in their strategizing and “what-if” scenarios. If you are analyzing a case, such as Mattel’s recalls, you can use this framework to show what steps the organization *could* have taken to prevent such recalls, and steps actually taken to manage issues under investigation. You can also use a stakeholder analysis at any point in this model.

Figure 2.9 on page 66 is more specific and focuses on the evolution of an issue from inception to resolution. This framework, which is not organization-specific as is Figure 2.8, is most likely to be used by analysts and scholars studying issues that have warning signs which, if attention is given, can prevent escalating problems. In many cases, a stakeholder analysis can show why strategies and actions of particular stakeholders short-circuited the issue’s evolution through all the stages in this figure.

**First Approach: Six-Step Issue Management Process** The first method is the most straightforward. This approach is most appropriate for companies or groups trying to understand and manage their internal environments. A third-party observer could also use this approach to describe how a group acted in retrospect or could act in the future.

The process involves the following steps, illustrated in Figure 2.8.<sup>46</sup>

1. Environmental scanning and issues identification
2. Issues analysis
3. Issues ranking and prioritizing
4. Issues resolution strategizing
5. Issues response and implementation
6. Issues evaluation and monitoring

These steps are part of a firm's corporate planning process. In the strategic issues management process, a firm uses a selected team to work on emerging trends as they relate to the industry and company. As Heath (2002) noted, "The objective of issues management is to make a smart, proactive, and even more respected organization. This sort of organization is one that understands and responds to its stakeholders and stakeholders."<sup>47</sup>

This framework is a basic approach for proactively mapping, strategizing, and responding to issues that affect an organization. For example, with regard to Mattel's recall in the opening case, if you, as an objective third-party observer, were analyzing Mattel's recall strategy, what issues could you identify that might affect the company? As you identify each issue (step 1), you might also begin to analyze the impact of the issue on the organization and other stakeholders (step 2). For example, cost savings might be a reason to outsource, but the following issue could emerge: "Have all the overhead costs, not just the labor hours worked, been calculated into the savings?" When analyzing outsourcing issues, you may question the possible lack of quality, satisfaction with results, and problems to be anticipated in communicating complex tasks between U.S. and Chinese subcontractors. As you move through the other steps of this model, this process should inform you of the "bigger picture" of costs and benefits of specific issues between Mattel and its outsourced subcontractors. Different issues are also likely to emerge, such as the extent to which Mattel's U.S.-based legal constraints and standards can be expected from Chinese subcontractors. What risks is Mattel willing to assume by using international contractors?

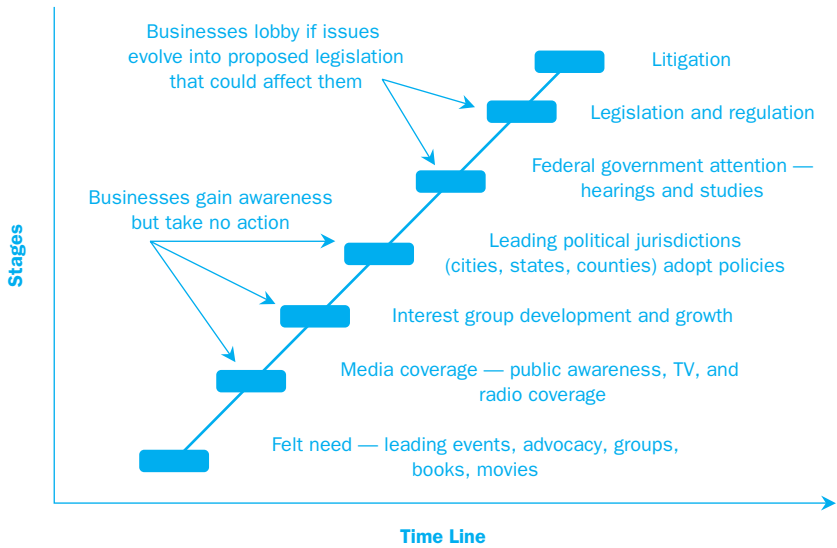
This six-step process also enables you to advise upper-level managers and directors in the company regarding precautions to take to avoid the illegal and unethical consequences of an issue. This model sharpens your ability to see the effects of issues on organizations from conception to response and monitoring.

**Second Approach: Seven-Phase Issue Development Process** Issues are believed to follow a developmental life cycle. Views differ on the stages and time involved in the life cycle. Steven Fink's method of analyzing an eight-year issue's life is illustrated in Figure 2.9. It is instructive to understand some of the life-cycle stages suggested for tracking an issue.<sup>48</sup>

1. A felt need arises (from emerging events, advocacy groups, books, movies).
2. Media coverage is developed (television segments, such as on *60 Minutes*, *20/20*, *FOX News channel*, *CNN*, and breaking news on the Internet from the *Wall Street Journal*, *New York Times*, and other news and blogging sources).
3. Interest group development gains momentum and grows.

Figure 2.9

### Seven-Phase Issue Development Process



4. Policies are adopted by leading political jurisdictions (cities, states, counties).
5. The federal government gives attention to the issue (hearings and studies).
6. Issues and policies evolve into legislation and regulation.
7. Issues and policies enter litigation.

Mattel's CEO and top-level team could have used this framework to anticipate and perhaps prevent the recalls, and also respond to the public in a more timely way. With the Internet, it no longer takes seven years for this model to move from phase one to the last (litigation) phase. Once local and federal legislators learn about a volatile news-breaking public issue, especially if the media has exposed it, company representatives may respond sooner.

Related to the Mattel toy recalls and its partnership with Chinese contractors and subcontractors, the outsourcing debate in general is a relevant topic to analyze using this second issues framework. Christopher Clott's article, "Perspectives on Global Outsourcing and the Changing Nature of Work,"<sup>49</sup> provides excellent background information for such an assignment. Other industries that are outsourcing are facing consumer and watchdog organizations' scrutiny as ethical issues surface. For example, the accounting industry is being watched as issues evolve over the outsourcing of confidential client information. Steven Mintz (2004) observes,

Outsourcing the preparation of income tax returns overseas raises significant ethical issues. Reports of the scope and size of the outsourcing market vary greatly, but the largest outsourcing companies claim that thousands of returns were processed during the 2003 tax season. SurePrep claims to have processed 6,000 returns last year and expects to process as many as 30,000 by April 2004. SurePrep electronically transmits tax information to preparers in India.

Four rules in the AICPA Code of Professional Conduct are of particular relevance to tax outsourcing; Rule 102, Integrity and Objectivity; Rule 201, General Standards; Rule 202, Compliance with Standards; and Rule 301, Confidential Client Information. The outsourcing of tax services continues a disturbing trend in the accounting profession of placing pecuniary interests ahead of the public interest.<sup>50</sup>

Stakeholder management methods can be used with this issue management approach in order to identify those groups and individuals who moved an issue from one stage to another and who helped change the nature of an issue. Usually different stakeholder groups redefine issues as these constituencies compete with one another, using different sources of power, as discussed earlier.

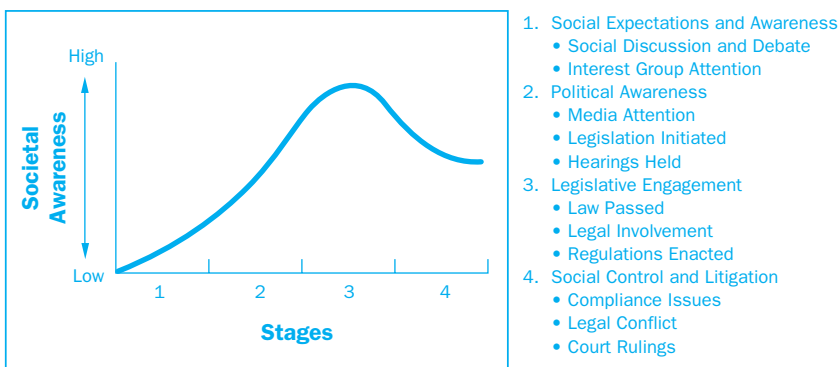
This seven-step framework is also useful in identifying and following public issues that do not necessarily originate with corporations. For example, MADD (Mothers Against Drunken Drivers), obesity, global warming, and natural disasters such as Hurricane Katrina or the 2004 Indian Ocean earthquake and tsunami. Issues frameworks and stakeholder analysis can help identify the effectiveness of public and private organizations in detecting and responding to events that result in crises. Sometimes the aftermath of a catastrophic event can result in a larger crisis than the precipitating event itself.

**Four-Stage “Life Cycle” Model** Thomas Marx<sup>51</sup> offered a related model as the seven-phase issue framework presented above. Marx observed that issues evolve across a four-stage “life cycle” from social expectations to social control through the following steps (Figure 2.10).

1. Social expectations
2. Political issues
3. Legislation
4. Social control

Figure 2.10

### Life Cycle Issue Development



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Marx's "Social expectations" phase is similar to the "felt need" stage in the seven-phase framework presented above. The "political issues" life cycle phase incorporates the "media coverage," "interest group development and growth," and "leading political jurisdictions adopt policies" dimensions of the seven-phase approach. The "legislative" phase is equivalent to the "federal government attention (hearings and studies)" and "legislation and regulation" phases of Fink's framework. Marx's "social control" phase includes Fink's "litigation" phase.

Marx illustrated his framework with the origins of the automobile safety belt issue. The four stages of this case, according to Marx, were reflected by the following events:

1. Ralph Nader's now-classic book, *Unsafe at Any Speed*, published in 1965, created a social expectation regarding the safe manufacturing of automobiles. The Chevrolet Corvair, later pulled off the market, was the focus of Nader's astute legal and public advocacy work in exposing manufacturing defects.
2. The National Traffic and Motor Vehicle Safety Act and the resulting safety hearings in 1966 moved this expectation into the political arena.
3. In 1966, the Motor Vehicle Safety Act was passed, and four states began requiring the use of seat belts in 1984.
4. Social control was established in 1967, when all cars were required to have seat belts. Driver fines and penalties, recalls of products, and litigation concerning defective equipment further reinforced the control stage.

Nader's pioneering consumer advocacy and legal work with regard to U.S. automobile manufacturing set an enduring precedent for watchdog congressional and voluntary advocacy groups.

Selecting an issue in the news and tracing its path through these different stages provides a window into the emergence and evolution of public issues to laws in the U.S. society. Issues are not static or predetermined commodities. Stakeholder interests and actions move or impede an issue's development. To understand how an issue develops, or is unable to develop, is to understand how power works in a political system in which market and nonmarket forces pressure the ethics and values of stockholders and stakeholders.

## 2.8 MANAGING CRISES

In 1989, a British Midland Airways Boeing 737 crashed on the M1 motorway in Leicestershire, England, killing 47 people. British Midland Chairman Sir Michael Bishop lost no time going to the scene and telling the press that as the head of the company, he was responsible. There was no hiding behind official inquiries or obfuscation. His crisis leadership technique was clear, sympathetic, positive, and transparent. The person in charge was visible, coherent, and reassuring. Bishop always kept the press informed of the inquiry and what British Midland was going to do next. Consequently, his lead during a time of intense crisis is noted as a good example of crisis management from the top. Despite an enormous tragedy caused by technical and human failings, the company remains a profitable enterprise.<sup>52</sup>

“Crisis management” methods evolved from the study of how corporations and leaders responded (and should have responded) to crises. Using crisis management with stakeholder methods is essential for understanding and possibly preventing future fiascos because crises continue to occur in a number of areas: product/service crises (e.g. JetBlue’s 2007 weather-related mishap); consumer products (the crisis with Ford’s use of Firestone’s faulty tires), financial systems (Enron; the subprime lending crisis), and government/private contractor projects (Boston’s 2006 Big Dig tunnel partial ceiling collapse, Challenger shuttle launch). Sir Michael Bishop’s response to the crisis he faced in the previous scenario is a success story. Unfortunately, most corporate leaders have not responded so courageously.

Steven Fink (1986) states that a crisis is a “turning point for better or worse,” a “decisive moment” or “crucial time,” or “a situation that has reached a critical phase.” He goes on to say that crisis management “is the art of removing much of the risk and uncertainty to allow you to achieve more control over your destiny.”<sup>53</sup> Crises, from a corporation’s point of view, can deteriorate if the situation escalates in intensity, comes under closer governmental scrutiny, interferes with normal operations, jeopardizes the positive image of the company or its officers, and damages a firm’s bottom line. A turn for the worse also could occur if any of the firm’s stakeholders were seriously harmed or if the environment was damaged. The following two approaches describe ways that organizations can respond to crises. You may turn to Chapter 4 to review some of the classic corporate crises that have occurred over the past few decades. Having such examples as the Exxon Valdez, the Ford Pinto disaster, and other crises in mind would be informative as you read how to examine and respond to a crisis from a stakeholder management perspective.

The model in Figure 2.11 shows a crisis consisting of four stages: (1) prodromal (precrisis), (2) acute, (3) chronic, and (4) resolved. Judgment and observation are required to manage these stages. This approach differs from the second one in that a “precrisis stage” is shown.<sup>54</sup>

The *prodromal stage* is the warning stage. If this stage is not recognized or does not actually occur, the second stage (acute crisis) can rush in, requiring damage control. Clues in the prodromal stage must be carefully observed.

Figure 2.11

### Four Crisis Management Stages

Stage 1	Stage 2	Stage 3	Stage 4
<b>Precrisis</b>	<b>Crisis occurs</b>	<b>Lingering</b>	<b>Health restored</b>
PRODROMAL STAGE	ACUTE STAGE	CHRONIC STAGE	CONFLICT RESOLUTION STAGE
Warning; symptoms	Point of no return	Self-doubt, self-analysis	Return to normalcy

For example, Mattel experienced several recalls with its Chinese subcontractors. The first recall sent a warning sign that issues existed. Mattel representatives at first let the subcontractor take the blame. Why were these warning signs not taken more seriously?

In the second stage, *acute crisis*, damage has been done. The point here is to control as much of the damage as possible. This is often the shortest of the stages. In some crises, like the Challenger space launch, the acute crisis stage involved the explosion of the craft and deaths of the crew. In 2005, a toddler died from ingesting a magnet from a Mattel toy that was manufactured in China. While there were no laws governing this type of incident and Mattel had not considered the risk of a child ingesting a magnet, a child's death signaled a crisis.

The third stage, *chronic crisis*, is the clean-up phase. This is a period of recovery, self-analysis, self-doubt, and healing. Congressional investigations, audits, and interviews occur during this stage, which can linger indefinitely, according to Fink. A survey of *Fortune* 500 CEOs reported that companies that did not have a crisis management plan stayed in this stage two and a half times longer than those who had plans. Did Mattel's leaders' actions during its chronic stages of recalls—first with the death of a child and the magnet recall, then with the lead paint recall—demonstrate a strong ethical concern for its stakeholders and the public?

The final stage, *crisis resolution*, is the crisis management goal. The key question here is: What can and should an organization's leaders do to speed up this phase and resolve a crisis once and for all? Is Mattel acting more ethically responsible after its recalls to date?

## How Executives Have Responded to Crises

Not all CEOs and organizational leaders respond the same to crises. Jet-Blue's founder and CEO, David Neeleman, resigned as CEO and issued a customer "Bill of Rights" after the worst crisis in the airline's history during the winter of 2007 when "nine airplanes full of angry passengers sat for six hours or more on the tarmac at John F. Kennedy International Airport in New York."<sup>55</sup> However, a classic crisis management model developed by Matthews, Goodpaster, and Nash<sup>56</sup> suggested a different type of CEO response mode in their five phases of corporate social response to crises related to product crisis management. This model is based on the authors' study of how corporations have responded to serious crises. The phases, illustrated in Figure 2.12, are (1) reaction, (2) defense, (3) insight, (4) accommodation, and (5) agency. Reread the Mattel case at the end of this chapter and apply this crisis management method as you continue reading.

This approach can be used to examine and evaluate the moral responsibilities of corporate responses to crises. These authors studied the classic product crises as well as more recent cases. It is interesting to observe how some executives continue to deny or avoid responsibility in crises that become disastrous. Knowledge of these stages certainly would be a first step toward corporate awareness. Let's look more closely at each stage.

Figure 2.12

### Corporate Social Response Phases



The *reaction* stage is the first phase when a crisis has occurred. Management lacks complete information and time to analyze the event thoroughly. A reaction made publicly that responds to allegations is required. This stage is important to corporations, because the public, the media, and the stakeholders involved see for the first time who the firm selects as its spokesperson, how the firm responds, and what the message is.

The second stage, *defense*, signals that the company is overwhelmed by public attention. The firm's image is at stake. This stage usually involves the company's recoiling under media pressure. But this does not always have to be a negative or reactive situation.

The third stage, *insight*, is the most agonizing time for the firm in the controversy. The stakes are substantial. The firm's existence may be questioned. The company must come to grips with the situation under circumstances that have been generated externally. During this stage, the executives realize and confirm from evidence whether their company is at fault in the safety issues of the product in question.

In the fourth stage, *accommodation*, the company either acts to remove the product from the market or refutes the charges against product safety. Addressing public pressure and anxiety is the task in this stage.

During the last stage, *agency*, the company attempts to understand the causes of the safety issue and develop an education program for the public.

How did the CEO in the Mattel case perform according to this method of crisis management in each recall? To address this question, apply an issues management approach. Observe (research) news and media reports on the Internet of this and other crises. Apply this model and compare how company executives and spokespersons handled crises. Take special note of how companies respond morally to their stakeholders. Observe the relative amount of attention companies sometimes give to consumers, the media, and government stakeholders. Use the frameworks in this chapter to help inform your observations and judgments. Develop a timeline as the crisis unfolds. Notice who the company chooses as its spokesperson. Determine how and why the company is assuming or avoiding responsibility.

## Crisis Management Recommendations

A number of suggestions that corporations can follow to respond more effectively to crises are briefly summarized here. More in-depth strategies and tactics can be found in several sources.<sup>57</sup>

- Face the problem: Don't avoid or minimize it. Tell the truth.
- Take your "lumps" in one big news story rather than in bits and pieces. "No comment" implies guilt.
- Recognize that, in the age of instant news, there is no such thing as a private crisis.
- Stage "war games" to observe how your crisis plan holds up under pressure. Train executives to practice press conferences, and train teams to respond to crises that may affect other functional areas or divisions.
- Use the firm's philosophy, motto, or mission statement to respond to a crisis. For example, "We believe in our customer. Service is our business."
- Use the firm's closeness to customers and end users for early feedback on the crisis and to evaluate your effectiveness in responding to the events.

The following tactical recommendations are also helpful crisis prevention and management techniques:

- Understand your entire business and dependencies.
- Understanding your business provides the basis upon which all subsequent policies and processes are based and, therefore, should not be rushed.
- Carry out a business impact assessment.
- Having identified the mission critical processes, it is important to determine what the impact would be if a crisis happened. This process should assess the quantitative (such as financial and service levels) and the qualitative (such as operational, reputation, legal and regulatory) impacts that might result from a crisis and the minimum level of resource for recovery.
- Complete a 360-degree risk assessment.
- This is used to determine the internal and external threats that could cause disruption and their likelihood of occurrence. Utilizing recognized risk techniques, a score can be achieved, such as high-medium-low, one to 10, or unacceptable/acceptable risk.
- Develop a feasible, relevant, and attractive response.
- There are two parts to this stage: developing the detailed response to an incident and the formulation of the business crisis plan that supports that response.
- Plan exercising, maintenance, and auditing.
- A business crisis plan cannot be considered reliable until it has been tested. Exercising the plan is of considerable importance, as a plan untested becomes a plan untrusted.<sup>58</sup>

Finally, issues and crisis management methods and preventive techniques are only effective in corporations if:

- Top management is supportive and participates.
- Involvement is cross-departmental.
- The issues management unit fits with the firm's culture.
- Output, instead of process, is the focus.<sup>59</sup>

## CHAPTER SUMMARY

Organizations and businesses in the twenty-first century are more complex and networked than in any previous historical period. Because of the numerous transactions of corporations, methods are required to understand an organization's moral obligations and relationships to its constituencies.

The stakeholder management approach provides an analytical method for determining how various constituencies affect and are affected by business activities. The stakeholder approach also provides a means for assessing the power, legitimacy, and moral responsibility of managers' strategies in terms of how they meet the needs and obligations of stakeholders.

Critics of stakeholder management argue that corporations should serve only stockholders since they own the corporation. They hold that stakeholder theory: (1) negates and weakens fiduciary duties managers owe to stockholders; (2) weakens the influence and power of stakeholder groups; (3) weakens the firm; and (4) changes the long-term character of the capitalist system. A major response to the critics that support stakeholder theory states that societies and economies involve market and non-market interests of diverse stakeholders as well as stockholders. To understand and effect responsible corporate strategies, methods that include different players and environmental factors—not just stockholders or financial interests—are required.

A stakeholder analysis is a strategic management tool that allows firms to manage relationships with constituents in any situation. An individual or group is said to have a "stake" in a corporation if it possesses an interest in the outcome of that corporation. A "stakeholder" is defined as an individual or group who can affect or be affected by the actions or policies of the organization.

Recent studies have indicated that profits and stockholder approval may not be the most important driving forces behind management objectives.<sup>60</sup> Job enrichment, concern for employees, and personal well-being are also important objectives. These studies reinforce the importance of the stakeholder management approach as a motivating part of an organization's social responsibility system.

The implementation of a stakeholder analysis involves a series of steps designed to help a corporation understand the complex factors involved in its obligations toward constituencies.

The moral dimensions of managerial roles also have a stakeholder perspective. The stakeholder approach can assist managers in resolving conflicts over individual rights and corporate objectives. This approach can help managers think through and chart morally responsible decisions in their work.

The use of the stakeholder analysis by a third party is a means for understanding social responsibility issues between a firm and its constituencies. Ethical reasoning can also be analyzed relative to the stakeholder approach.

Preventing and effectively negotiating disputes is a vital part of a professional's and leader's work. We discussed several alternative dispute resolution (ADR) methods in the chapter, emphasizing consensual, relational, and integrative methods that seek "win-win" approaches. The full range of

dispute resolution methods is important to learn because conflict is part of ongoing organizational change.

Issues and crisis management frameworks complement the stakeholder analysis as social responsibility methods. Understanding what the central issues are for a company and how the issues evolved over time can help effectively and responsibly manage changes in a company's direction and operations. Crisis management frameworks help to predict, prevent, and respond to emergencies. Issues and stakeholder management methods used together provide an overall approach to leading and managing organizational change responsibly and ethically.

### ETHICAL INSIGHT 2.1



Crisis management experts criticized Bridgestone/Firestone for minimizing their tires' problems during the week of August 11, 2000. The experts gave the company mixed reviews on its handling of the recall of 6.5 million tires that were responsible for 174 deaths and more than 300 incidents involving tires that allegedly shredded on the highway in 1999. The tiremaker spokespersons claimed the poor tread on the tires was caused by underinflation, improper maintenance, and poor road conditions.

Mark Braverman, principal of CMG Associates, a crisis-management firm in Newton, Massachusetts, noted that the company blamed the victim and that Bridgestone/Firestone lacked a visible leader for its crisis-management effort. "The CEO should be out there, not executive vice presidents."

Steve Fink, another crisis-management expert, noted, "After they [Bridgestone/Firestone] announced the recall, they were not prepared to deal with it. They were telling consumers they will have to wait up to a year to get tires. And things like busy telephone call lines and overloaded Web sites—

these are things that can be anticipated. That's basic crisis management."

Stephen Greyser, professor of marketing and communications at Harvard Business School, stated, "It's about what they didn't do up to now. The fact that the company [Bridgestone/Firestone] is just stepping up to bat tells me they've never really had the consumer as the principal focus of their thinking."

Defending the way Bridgestone/Firestone handled the crisis was Dennis Gioia, professor of organizational behavior at Smeal College of Business Administration at Pennsylvania State University: "With hindsight, you can always accuse a company of being too slow, given the history of automotive recalls. Sometimes you can't take hasty action or you would be acting on every hint there's a problem. It can create hysteria."

### Question for Discussion

Who do you agree or disagree with among these crisis-management consultants? Explain.

**SOURCE:** Consultants split on Bridgestone's crisis management. (August 11, 2000). *Wall Street Journal*, A6.

## QUESTIONS

1. What, if anything, should Mattel's CEO have done differently in this scenario/case to have prevented and/or avoided the resulting crisis? Explain.
2. Briefly describe a dispute in which you were a major stakeholder. How was the situation resolved (or not resolved)? What methods were used to resolve the situation? Looking back now, what methods could or should have been used to resolve that situation? For example, what would you now recommend happen to effectively resolve it fairly?
3. Which of the types of power (described in this chapter) that stakeholders can use have you effectively used in a conflict or disagreement over a complex issue? Briefly explain the outcome and evaluate your use(s) of power.
4. Which roles and responsibilities in this chapter have you assumed in an organization? What pressures did you experience in that role that presented ethical dilemmas or issues for you? Explain.
5. What reasons would you offer for encouraging leaders and/or managers to use the stakeholder approach? Would these reasons apply to teams?
6. Give a recent example of a corporation that had to publicly manage a crisis. Did the company spokesperson respond effectively to stakeholders regarding the crisis? What should the company have done differently in its handling of the crisis?
7. Describe how you would feel and what actions you would take if you worked in a company and saw a potential crisis emerging at the "prodromal" or precrisis stage. What would you say, to whom, and why?
8. Using Figure 2.4, identify a complex issue-related controversy or situation in which you, as a stakeholder, were persuaded to move from one position (cell) to another and why—e.g., from nonsupportive to supportive, or from mixed blessing to marginal. Explain why you moved and what the outcome was.
9. Argue both the pros and cons of stakeholder theory, using some of the arguments in the chapter, as well as your own. What is your evaluation of the usefulness of stakeholder theory and methods in understanding and analyzing complex issues?

## EXERCISES

1. Describe a situation in which you were a stakeholder. What was the issue? What were the stakes? Who were the other stakeholders? What was the outcome? Did you have a win-win resolution? If not, who won, who lost, and why?
2. Recall your personal work history. Who were your manager's most important stakeholders? What, in general, were your manager's major stakes in his or her particular position?
3. In your company, or one in which you have worked, what is the industry? The major external environments? Your product or service?



Describe the major influences of each environment on your company (for example, on its competitiveness and ability to survive). Evaluate how well your company is managing its environments strategically, operationally, and technologically, as well as in relation to products and public reputation.

4. Choose one type of functional area manager described in the chapter. Describe a dilemma involving this manager, taken from a recent media report. Discuss how a stakeholder analysis could have helped or would help that manager work effectively with stakeholders.
5. Describe a complex issue that is evolving in the news or media. Explain how the issue has evolved into other issues. Which issues management framework would help track the evolution of this issue? Explain.
6. Describe a recent crisis that involved a product. Which phase of the crisis management model do you believe is the most important for all involved stakeholders? Explain.

**REAL-TIME ETHICAL DILEMMA**

Last year, I worked as a marketing manager in Belgium for a mid-sized engineering company. Total revenues for the company were \$120 million. The company had recently gone public and, in two public offerings, had raised more than \$60 million dollars. The firm was organized into four distinct strategic business units, based on products. The group that I worked in was responsible for more than \$40 million in sales. We had manufacturing plants in four countries.

Our plant in Belgium manufactured a component that was used in several products, which produced \$15 million in revenue. However, these products were old technology and were slowly being replaced in the industry. The overhead associated with the plant in Belgium was hurting the company financially, so they decided to sell the facility. The unions in Belgium are very strong and had approved the final sale agreement. After this sale, the work force was going to be reduced by half. Those who were laid off were not going to receive full severance pay, which, in Belgium, could take several years, and then workers would receive only 80% of total payment—a drastic change from what is offered in the United States. I was surprised that our executives in the United States had stated that the sales agreement was more than fair—contrary to the union’s position. A strike was imminent; the materials manager was told to stock 10 weeks of product.

My ethical dilemma started after the strike began. Originally, the company thought the strike would not

last longer than a couple of days. Instead of causing a panic among our customers, management decided to withhold information on the strike from our customers and sales force. I could understand the delay in telling our customers, but to withhold information from our sales force was, I believed, unconscionable. Inevitably, our inside sales representatives became suspicious when they called the Belgium plant to get the status of an order, and nobody answered. They called me, and I ignored the corporate request and informed them of the strike. When it became obvious that the strike was going to be longer than anticipated, I asked the vice presidents of marketing and sales about our strategy for informing the affected customers. They looked at me quizzically and told me to keep things quiet (“don’t open a can of worms”) because the strike should be over soon. In addition, they dictated that customer service should not inform customers of the strike and excuses should be developed for late shipments.

The strike lasted longer than 12 weeks. In this time, we managed to shut down a production line at Lucent Technologies (a \$5-million customer) with only a couple of days’ notice and alienated countless other valuable and loyal customers. I did not adhere to the company policy: I informed customers about the strike when they inquired about their order status. I also told customer service to direct any customer calls to me when we were going to miss shipments. This absolved them of the responsibility to tell the customer.

*(continued)*

**(Continued)**

We did not take a proactive stance until 11 weeks into the strike, when the vice president of sales sent a letter informing our customers about the strike—too little and much too late to be of any help. The materials manager was fired because he only stocked 10 weeks of product even though management thought he should have been conservative with his estimates. Halfway through this ordeal, I updated my resume and started a search for a new job. It was clear that management was more concerned about their year-end bonus than doing the right thing for the

long-term prospects of the company and its customers.

**Questions**

1. Do you agree with the writer's decision to inform customers about the strike? Explain.
2. Did management have the right to withhold this information from customers? Explain.
3. Explain what you would have done, and why, if had you been in the writer's situation.
4. What should management have done in this case? When? Why?

## Case 3

### Mattel Toy Recalls

#### Product Recalls at Mattel Inc.

On August 2, 2007, NBC's John Yang reported on the *Today* show of a "global recall" from Fisher Price involving approximately one million toys. With initial reactions from stunned mothers, the report represented public anxiety over the risk to children's safety. That recall would be only the first of three major recalls in that month for Mattel, the parent company of Fisher Price. There had been critical steps preceding these recalls; additional actions followed.

This case describes the actions taken by key stakeholders during Mattel's three major recalls in August 2007, one of which was the largest recall initiated by the world's largest toy company.

**Where it Began** According to Mattel executives, lead paint was discovered on some of its toys by a European retailer. On July 6, 2007, Mattel halted the production of toys at the manufacturing plant that produced the toys while the company initiated an investigation. On July 18, Mattel gave a *New York Times* reporter a tour of the manufacturing facility in Guanyao, China, and its safety lab in Shenzhen, China. Mattel's position during the investigation was that it was unaware of whether the issue was an isolated problem or if there was a larger scale impact.

On July 26, Mattel executives received data that confirmed there was a safety risk in 83 of their products. This prompted them to contact their retailers who were distributing the affected toys. The communication was made to the public on August 1, 2007. According to Mattel, the issue was self-identified and the Consumer Product Safety Commission was made aware of the problem. David Allmark, general manager of Fisher Price, a division of

Mattel, committed to vigorously investigate and learn from the problem through the following statement: "We are still concluding the investigation, how it happened. But there will be a dramatic investigation on how this happened. We will learn from this." Allmark also indicated that the recall was accelerated, which gave Fisher Price the opportunity to quarantine approximately two-thirds of the 967,000 toys before they were sold to the public.

On August 8, Mattel identified the vendor responsible for the recalled toys. Mattel's CEO, Robert Eckert, issued the following statement during an interview regarding the contract manufacturer that produced the toys: "This is a vendor plant with whom we've worked for 15 years; this isn't somebody that just started making toys for us." In an interview, Eckert stated: "They understand our regulations, they understand our program, and something went wrong. That hurts." Mattel further communicated that they were unaware of whether the manufacturer had received materials from a certified supplier or if they had substituted materials from a non-certified supplier.

On August 11, 2007 the lead executive of the manufacturing company linked to the Mattel recall of toys containing lead-based paint committed suicide. Zhang Shuhong, who led the Lee Der Industrial Co., was found dead in his factory in China.

**More Bad News** On August 14, 2007 Mattel issued two additional recalls related to toys developed by Chinese contract manufacturers. The first action was a second instance of lead paint discovered in a die cast vehicle model marketed as a character from the movie, *Toys*. This recall affected 436,000 toys, all of which were

manufactured by a different company than Lee Der Industrial Co. According to Mattel, the products were manufactured between May and July of 2007 and were discovered as part of a systemic review of its toy manufacturing following the initial finding of lead paint.

The second action was taken to expand the scope of an earlier recall to address 18.2 million magnetic toys that had a “design flaw.” The recall included 63 types of toys that had been manufactured since 2002 and were confirmed by the Consumer Product Safety Commission as having been manufactured in China. This “design flaw” allowed small magnets to come apart from the toy with the risk of being swallowed by children. The first incident likely came from seven-year-old Paige Kostrzewski in July, 2005. Kostrzewski had accidentally swallowed two magnets, which then gravitated to each other based on their magnetic pull while inside her intestines. Surgery revealed that the magnets had punctured holes in her intestines, and, according to her mother, “caused everything to just seep into her body.” Luckily, Kostrzewski recovered after a two-week hospital stay and follow-up treatment to address an infection. As a result, in November 2005, Mattel voluntarily recalled 4.4 million of the models, 2.5 million of which were in the United States.

In terms of the August 14th recall, Nancy A. Nord of the Consumer Product Safety Commission indicated that no recent injuries had been reported for the products being recalled and that the action was “intentionally broad to prevent injuries.” However, previous recalls in November 2005 of the magnetic “design flaw” in Polly Pocket toys did include injuries. Specifically, 19 children have required surgery and one child has died since 2003. According to a *New York Times* article, “Mattel Recalls 19 Million Toys Sent From China,” published on August 15, 2007, Mattel executives had stated the previous day that “in the long run [we] are trying to shift more of [our] toy production into factories [we] own and operate—and

away from Chinese contractors and sub-contractors.” However, the same article clarified that the cause of the recall was based on a design flaw, and that while the Chinese manufacturers were producing the toys, the design of the product was developed by Mattel—who is ultimately responsible for the specification.

**What Took So Long?** Following the recalls, public speculation grew as to whether Mattel could have warned the public of these safety risks any earlier. Gerrick Johnson, an analyst with BMO Capital Markets, indicated that Mattel could have alerted the public sooner through the following comments: “You have to alert the public right away. I think it’s a public relations nightmare more than anything else.” Other analysts believe the company has been proactive and transparent. Sean McGowan, an analyst at Wedbush Morgan Securities Inc. felt Mattel would achieve a “long-term trust” as a result of Mattel “being honest about investigating any other problems.”

According to a *Wall Street Journal* article, “Safety Agency, Mattel Clash Over Disclosures,” the Consumer Product Safety Commission has a policy that requires manufacturers to report “all claims of potentially hazardous product defects within 24 hours, with few exceptions.” In the case of the recall of 18 million magnetic toys, Mattel took months to collect and analyze data and reports before notifying the agency. Companies that produce similar toys as Mattel with magnetic components have worked with the Consumer Safety Commission since early 2006.

Based on the company’s history, this non-compliance represents a systemic practice. The company has been fined twice for what was described as “knowingly withholding information regarding problems that “created an unreasonable risk of serious injury or death.”

The first incident was related to a failure to report a fire hazard in a timely manner for its Power Wheels motorized toys, which were intended to be ridden

by children aged two years or older. According to Ann Brown, chair of the Consumer Products Safety Commission, Mattel knew of the risk to children's safety, however "did nothing for years." The penalty for not reporting the hazard to the agency was assessed in 2001 after a recall of 10 million toys in 1998. According to the agency, there were approximately 150 reports of fires in the Power Wheels cars as well as up to 10 times that number of complaints for overheating and other deficiencies prior to the company's issuing the recall. The Consumer Products Safety Commission remained skeptical of Mattel's handling of the Power Wheels recall, and initiated at least nine different investigations into whether problems had occurred following the recall.

The second fine was issued for a problem that occurred just a year after the Power Wheels penalty. In 2002, Mattel became aware of issues with its Little People Animal Sounds Farm. The complaints claimed that tiny screws used in the farm could become loose and pose the risk of a child accidentally swallowing them. In an investigation conducted by the U.S. government, it was determined that Mattel was made aware of 33 reports of this safety hazard—including one instance of a baby swallowing the screw, which required emergency surgery—before informing the Consumer Products Safety Commission. Mattel reached a settlement of 975,000 dollars, yet denied any wrongdoing. A recall of the product was initiated in April 2003.

Mattel is also under scrutiny for the more recent recalls involving the 18 million units of toys containing magnetic components. Between the initial Polly Pocket recall in November 2006 and the expanded recall of August 2007 for the same issue, Mattel received an additional 400 reports of similar magnetic hazards with different toys. It is not currently known how long Mattel waited before notifying the agency of these reports. The Consumer Product Safety Commission is currently investigating Mattel on the timeliness of its reporting

practices and has not made that information public. However, when Mattel CEO Robert Eckert was asked in September 2007 of the date of disclosure for the magnetic component recall, he responded that he "he couldn't remember when the company brought the complaints about the magnets to the attention of authorities."

While there have been specific cases of untimely disclosures from Mattel, there have also been comments issued from Eckert rationalizing Mattel's untimely practice and justifying its position for waiting extended periods before notifying the agency and the public. Eckert has claimed that the company discloses problems on its own timetable due to a belief that the regulatory requirements are "unreasonable." Furthermore, Eckert claimed that Mattel should have the ability to evaluate any reports of safety hazards prior to reporting them to the agency or the public. The Consumer Product Safety Commission disagreed in a statement issued by the agency's spokesperson, Julie Vallese: "It's a statute; it's clear." In late 2007, the agency initiated a formal investigation into the timeliness of Mattel's hazardous incidents reporting process to examine its more recent disclosures.

**The Aftermath** Following the lead paint recall on August 1, 2007, Mattel communicated that it would evaluate methods of addressing the problem. Mattel CEO Robert Eckert indicated that this would include the possibility of reducing the amount of toys it produces through contract manufacturers. In what appeared to be an attempt at distancing itself from its Chinese contract manufacturers, Eckert issued the following statement: "I, like you, am deeply disturbed and disappointed by recent events. We were let down, and so we let you down."

Despite comments that deflected a portion of the responsibility, Eckert also made statements following the second cycle of recalls issued on August 14 which attempted to appease consumers and regain their trust. In a full-page

advertisement taken out in major newspapers such as the *New York Times*, *USA Today*, and the *Wall Street Journal*, Eckert stated: “Our long record of safety at Mattel is why we’re one of the most trusted names with parents, and I am confident that the actions we are taking now will maintain that trust.”

Following the initial comments issued by Mattel, Chinese manufacturers defended themselves against inferences that U.S. companies did not share the blame. The following statement was issued by China’s General Administration of Quality Supervision, Inspection and Quarantine: “Chinese original equipment manufacturers were doing the job just as importers requested, and the toys conformed with the U.S. regulations and standards at the time of the production.” Specific to Mattel, the organization stated: “Mattel should improve its product design and supervision over product quality.”

In September 2007, Mattel seemed to agree with the Chinese position, and launched a public relations campaign to issue a formal apology to those in China whose reputations were affected. Mattel’s executive vice president for Worldwide Operations, Thomas Debrowski, met with the head of Chinese Product Safety, Li Changjiang, to issue the following statement: “Mattel takes full responsibility for these recalls and apologizes personally to you, the Chinese people, and all of our customers who received the toys.” Debrowski went on to specifically identify the design flaw as the root cause of the magnetic-component-based recall: “The vast majority of those products that were recalled were the result of a design flaw in Mattel’s design, not through a manufacturing flaw in China’s manufacturers.” In addition, the company issued a formal statement which referenced the lead paint recall as well. The statement called the scope of the recall “overly inclusive, including toys that may not have had lead in paint in excess of the U.S. standards.”

The statement continued, “The follow-up inspections also confirmed that part of the recalled toys complied with the U.S. standards.”

On September 12, 2007, a congressional hearing was held to attempt to identify what needed to be done to ensure that the types of recalls issued by Mattel do not continue. Congress assigned equal blame to all parties across the board, including the Chinese safety standards, Mattel, and the Consumer Products Safety Commission.

Mattel recognized its level of responsibility through a response from Eckert: “We are by no means perfect.” Mattel continued that it would rectify the situation by taking steps such as better oversight of quality controls for its contract manufacturers and instituting its own laboratories for testing of its products.

The Consumer Products Safety Commission has conceded that it is understaffed. From 1974 to 2007, the agency’s employee number has been reduced from 800 to 400. What is even more alarming is that there is only one resource dedicated to the actual testing of toys.

The Chinese manufacturers were also identified by Congress. Republican Senator Sam Brownback of Kansas concluded that “‘Made in China’ has now become a warning label.” Brownback continued: “We’re seeing this in the charts and we’re seeing it in the products and it’s got to stop.”

While the fallout from the 2007 toy recalls will continue for Mattel and all parties involved, the result will likely be stricter policy, stronger internal quality controls, and improved subcontractor oversight, all of which will ultimately benefit consumer safety.

## Questions for Discussion

1. Identify the major stakeholders in the case and answer the question, “Who was responsible for what went wrong and why?”
2. What are the ethical issues in the case, and for whom?

3. Do you think cross-cultural dynamics and misunderstandings played a role in the resulting problems in the case? Explain.
4. Was there a “prodromal phase” in this case? If so, identify this stage and the event(s) that explain it.
5. Which issues management framework would you suggest to best explain this case? Why?

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## Case 4

### JetBlue: Bringing Humanity Back to Air Travel?

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**Industry History** In 1903, the Wright brothers' first successful flight in Kitty Hawk, North Carolina, marked the beginning of the aviation industry. Although using airplanes for travel purposes did not become popular until after WWI, a new industry was born. The first air transport company was The American Aviation Corporation, which largely transported goods and materials all over the country. This would later grow into American Airlines and United Airlines. A major factor in the growth of the air transportation industry during this time was the development of a mail transport system by the U.S. Postal Service. The Kelly Airmail Act of 1925 gave private airlines the opportunity to function as mail carriers through involvement in a competitive bidding system. These private carriers, through the airmail revenue, could then expand into carrying other forms of cargo, including passengers.

With the United States' entry into World War II, commercial fleets and pilots were sent to Europe to participate in the war effort. The war also helped to generate support for research and development of aircraft, which extended beyond the war to commercial aviation. A major post-war development was the four-engine aircraft, such as the Lockheed Constellation. This innovation substantially cut the flying time for ocean and continent crossings. The 1950s saw dramatic improvements in the capacity and comfort of commercial flights. Planes were modernized, and jet service was introduced in 1959, enabling even faster cross-country service.

The most rapid change for the U.S. airline industry came in 1976 when the Civil Aeronautics Board asked Congress to dismantle the economic regulatory system and allow the airlines to operate under market forces. This changed the face of commercial aviation in the United States. Congress passed the Airline Deregulation Act in 1978, easing

the entry of new companies into the business and giving them freedom to set their own fares and fly whatever domestic routes they chose. And thus, the battle of the airlines began. New entrants swarmed the market, offering lower fares and new routes. However, in the late 1970s into the 1980s, a few major airlines dominated the U.S. market. Continental, United, Delta PanAm, Eastern and American were household names. Smaller, low cost airlines were having trouble breaking into the market, and rarely survived. But change was on the horizon.

In 1989, events began to unfold which severely damaged the economic foundations of the industry. The Gulf War crisis and economic recession in the United States caused the airlines to lose billions of dollars. The industry experienced the first drop in passenger numbers in a decade; by the end of the three-year period of 1989–1992 it had lost almost \$10 billion. It became apparent that airlines would have to change radically to ensure their survival and prosperity. With this revelation, the “low-cost carrier” sector of the airline industry started to gain popularity.

**Low-Cost Carriers** A low-cost carrier, also known as a “no-frills” or discount airline, offers low fares in exchange for eliminating many traditional passenger services. These airlines have a lower cost structure than competitors. They often operate a single passenger class (coach) and fleet, reducing training and servicing costs and have simplified routes and turnaround times. They tend to fly to cheaper, less congested airports, and offer customers a simple fare scheme and unreserved seating. They also have labor costs that are 30% to 40% lower than mainline carriers. The main target of these airlines are price-conscious consumers. Services such as complimentary

food and beverages are traded for the option to buy snacks and soft drinks, as well as alcohol at a low price. Although low-cost carriers are a relatively new offering in air travel, the concept was actually formed and implemented in 1971, when Southwest Airlines launched its first airplane, providing service between major cities in Texas. However, it would take 20 years before the idea of low-cost carriers operating flights all over the country would take root.

Southwest Airlines remained relatively unchallenged in the U.S. low-cost carrier sector of air travel until the inception of JetBlue in 1999. Until then, Southwest was going head to head with the major U.S. airline carriers. The major carriers attempted to fend off Southwest through allegedly anticompetitive behavior and by creating low-cost subsidiaries such as United Express, Continental Lite, and Delta Express, which eventually all failed. Even with new competition, Southwest remains the most successful low-cost airline in the United States and the most copied in the world. The founders of RyanAir in Europe and JetBlue in the United States actually flew to Texas to observe how the company was operated, taking this knowledge with them to start their own low-cost airlines.

**JetBlue Airways** Founded in February of 1999, JetBlue Airlines was the darling of former CEO David Neeleman. JetBlue entered the airline industry with a multitude of advantages that even Southwest did not have. The company started with the largest initial capitalization of any airline, with over \$160 million dollars. Likewise, powerful New York politicians, upset with high intra-New York state fares, provided JetBlue with a remarkable 75 slots at JFK airport. The airline's home base was JFK, and in 2001, it began operations out of California's Long Beach Airport. From the beginning, JetBlue competed with major air carriers on the East Coast (and later West Coast) and was formidable. JetBlue had a

very similar business model to that of Southwest, yet its fleet was newer and was outfitted with live satellite TV at every leather seat. The company also did not have labor relations issues to deal with, as its workforce is non-unionized.

The months following the September 11, 2001, terrorist attacks proved to be the most profitable for the company. JetBlue was one of only a few U.S. airlines that made a profit during the sharp downturn in airline travel following the attacks. The stock price was growing and so were profits. Financial results were strong for the airline throughout the 2002–2004 years, but they would not last. In October 2005, JetBlue announced that its quarterly profit had plunged from \$8.1 million to \$2.7 million largely due to rising fuel costs and “growing pains.” The growth rate for the company was becoming unsustainable, yet despite this, JetBlue kept expanding, buying new aircrafts and adding routes. It was this rapid growth that led JetBlue into one of the most embarrassing and unforgettable fiascos in the company's lifetime, one that would raise questions about customers' rights and the ethical and moral obligations of companies in this industry. It was known as the “Valentine's Day Nightmare.”

**The Valentine's Day “Customer Disaster”** On February 14, 2007, a severe ice-storm hit the New York area. Many airlines had cancelled flights ahead of time as a precaution for passengers and aircrafts. One airline that did not cancel flights was JetBlue. The company thought the weather would break and it would be able to fly, keeping its revenue flowing and its customers happy. This decision was a costly error. As the storm progressed, 10 JetBlue airplanes found themselves full of passengers and unable to take off. Planes literally became frozen to the tarmac and could not get back to the gates. Information from air traffic controllers was not coming in and the pilots had no instruction. Some planes sat for more than 10 hours on the runway. Toilets on the planes

began to back up, overflowing into the aisles, air ventilation was stopped, and passengers had little to no food. Many of these passengers were families with young children who were on their way to numerous destinations for the school vacation week. The flight crew gave no answers, and there were no buses dispatched to rescue the passengers. Frustration and anger began to mount. For some, this ordeal would end short of the record, held by Northwest Airlines, who in 1999 held their passengers on board for 11 hours. The situation inside the airport was not much better. Hundreds of passengers waited in hours-long lines for information on their flights. There were not enough JetBlue associates to direct and inform the mass of people, and JetBlue's 1-800 number could not handle the flood of calls. Passengers who had not yet boarded planes were stranded, and slept in the airport. Most flights had been cancelled. It was chaos.

When it was all over, JetBlue was left to deal with irate customers, overwhelmed employees, more than 1,000 cancelled flights (23% of overall flights as a result of the February 14 event), \$30 million in losses for refunds and travel vouchers issued to passengers, and incremental costs such as hiring overtime crews. JetBlue also had one very large blemish on its reputation. The company had some answering to do. It was a corporate and public relations nightmare.

**The Aftermath** Then-CEO David Neeleman immediately took responsibility for the crisis, apologizing in a formal letter, stating that he was "humiliated and mortified" by the breakdown in the airline's operations, and that the company had "learned a huge lesson" and vowed to do right by the company's customers. Neelman called the fallout of the ice storm a "defining moment" for the airline and said the company was implementing new policies and adding management to improve operations. One of these new policies was the "Customer Bill of Rights," which stated that JetBlue, among other

things, vowed to reimburse passengers impacted by ground delays and to remove passengers from planes left on the runway for more than 5 hours. The company also reviewed and published its code of ethics. Neeleman stated that "This is going to be a different company because of this." Yet, some customers and members of the public felt this admission and implementation of new policies was too little, too late. Some called for Neeleman's resignation, but he stated he had no intention of stepping down from his post.

So, what exactly led to this disaster for JetBlue? There are many theories, but the company admitted that it had made mistakes, especially in regards to its communications system. Neeleman stated that "the company's management was not strong enough" to handle the fiasco largely due to the "shoestring communications system that left pilots and flight attendants in the dark, and to an undersized reservation system." This system became overwhelmed, with customers unable to get through to human agents to check on a flight." Additionally, the company admitted that it "lacked the trained staff to find all of the attendants and pilots and tell them where to go." JetBlue was often cited as a favorite among passengers and had expanded rapidly, but its systems to deal with the consequences of bad weather did not keep up with the growth. The company's low-cost operating structure, a source of great pride, may have ultimately led to this unfortunate event.

Since the Valentine's Day Nightmare, JetBlue has followed through with its promises, training existing corporate office employees to work in operational modes during an emergency, beefing up the company's management, and enforcing the Customer Bill of Rights. Yet, one year later, questions still remain about the obligations that airlines have to their customers. In extreme situations, do airlines have a moral or ethical obligation to their passengers? How can a company like JetBlue bring "humanity back to air travel," when the

bottom line and cutting costs and fares in this industry is paramount?

### Questions for Discussion

1. What went wrong with JetBlue on Valentine's Day, 2007?
2. Was this event a "business-as-usual" problem, or was it something out of the ordinary? Explain.
3. Who was to blame for the problems that occurred? Why?
4. Were there any pre-crisis signs that the company would respond the way it did? If so, what were the indicators of a potential crisis reaction?
5. Evaluate JetBlue's handling of the "aftermath" of the event.

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## Case 5

### Arthur Andersen: Shredding the Reputation and Viability of a Once Venerable Accounting Firm

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Four days before the high-flying, energy-trading giant Enron disclosed a \$618 million loss for the third quarter of 2001, an attorney for Arthur Andersen, the accounting firm that audited Enron's books, wrote a memo to Andersen employees directing them to do something extraordinary. Andersen had a policy of retaining the key documents behind an audit, but getting rid of notes, drafts, and memos that were produced during the audit. The attorney, Nancy Temple, wrote in an e-mail to David Duncan, the Andersen partner in Houston who oversaw the Enron account, "[I]t might be useful to consider reminding the [Enron] engagement team of our documentation and retention policy... It will be helpful to make sure that we have complied with the policy." Duncan followed Temple's advice, and the Andersen engagement team was ordered to destroy all audit material related to the Enron account except for the most basic work papers. As the destruction directive was being fulfilled, the United States Securities and Exchange Commission (SEC) initiated a probe of Enron's business activities. In order to secure needed accounting documents and information, the SEC issued subpoenas to Enron's auditor on November 8, 2001. "Supervisors at Arthur Andersen repeatedly reminded their employees of the document-destruction memo" in the two weeks preceding issuance of the subpoenas. According to then-United States Deputy Attorney General Larry Thompson, "Andersen's staff destroyed more than two tons of paper related to its Enron work" and "undertook a systematic effort . . . to purge the computer hard drives and e-mail system of Enron-related files." According to a January 21, 2002 report in *Time* magazine, Andersen declined "to rule out the possibility that some destruction continued even after" the subpoenas were issued. Of course, any destruction of

documents after the issuance of a subpoena would be clearly illegal.

The Enron/Andersen accounting scandal unfolded at warp speed. Very quickly, Enron fell into bankruptcy and its stock became virtually worthless. Given the widespread, immediate, and dramatic impact of Enron's collapse on employees, stockholders, and the economy, no fewer than eight Congressional committees conducted hearings to determine how and why Enron failed. On January 15, 2002, David B. Duncan, Andersen's lead partner on the Enron account, was fired for directing the document-destruction binge. Andersen also put three partners in the Houston office on leave and relieved four other partners of all management responsibilities. And this was only the beginning—of the end! How could Arthur Andersen, once a venerable accounting firm headquartered in Chicago, end up having its reputation and very existence ripped to shreds?

The Enron debacle was not the first time that Andersen's local partners had been caught with their hands in the "accounting cookie jar." Two notable accounting transgressions occurred not too long before the Enron implosion. As a consequence of its involvement with Waste Management Inc. in an accounting scheme that inflated pretax income, Andersen settled shareholder lawsuits in 1998 for \$75 million and was fined \$7 million by the SEC in 2001. Andersen did not admit or deny the SEC's charges but did agree to the SEC's mandate that "future violations would carry stiffer sanctions." The other notable transgression involved Andersen's audit of Sunbeam, the appliance manufacturer. According to the SEC, Sunbeam was forced to restate earnings due to a "fraudulent scheme to create the illusion of a successful restructuring of Sunbeam and thus facilitate a sale of the company at an inflated price."

In March of 2002, Michael Chertoff, then an assistant attorney general at the Justice Department, sought an indictment against the company rather than specific individuals "because the firm had shredded massive quantities of Enron-related documents just as a government investigation was kicking into gear." According to former SEC chairman Arthur Levitt, Andersen's violation of the Waste Management consent decree was "one of the main reasons for indicting the entire firm, instead of just the individual Andersen partners involved in the Enron audits." After a six-week trial and ten days of jury deliberations, Andersen was found guilty of obstructing justice when it destroyed Enron documents while on notice of a federal investigation. "Andersen had claimed that the documents were destroyed as part of its housekeeping duties and not as a ruse to keep Enron documents away from the regulators." After the verdict, several jurors told CNN "that they had concluded Andersen officials had suddenly ramped up a dormant document destruction policy in October 2001, shredding tens of thousands of Enron-related papers. It was done when Andersen executives acknowledged in memos they were aware of a probable investigation into Enron's accounting practices."

After its conviction, Andersen "instantly withered to almost nothing, tens of thousands of innocent employees lost their jobs, and thousands of partners who knew nothing about the crime . . . lost nest eggs they'd been building for years." Jack Coffee, a law professor at Columbia University, "blames Andersen's fall not on the government's prosecution, but on the firm's unfortunate history with blown audits at the Baptist Foundation of Arizona, Waste Management, Enron, WorldCom and other clients." "What little public support Andersen enjoyed evaporated a few weeks after its conviction with the news that WorldCom, another Andersen client, had overstated its earnings by several billion dollars. Andersen also audited the books of

tarnished telecom companies Global Crossing and Qwest. Accounting irregularities at those companies spawned civil and criminal investigations." In a post-mortem analysis of Andersen's conviction, CNNMoney.com reporters wrote, "[T]he verdict will likely be a fatal blow for the 89-year-old accounting firm, which is now operating as a shell of its once-powerful self. The firm has laid off 7,000 employees, sold many of its practices in the United States and has lost more than 650 of its 2,300 public audit clients this year. Thousands more employees in the United States and around the world are likely to lose their jobs as the firm shrinks." Art Bowman, editor of *Bowman's Accounting Report*, a magazine that covers the accounting industry said, "[T]he name Arthur Andersen, once held in high regard, is now a joke."

Andersen decided to appeal the conviction not because the firm's lawyers believed that the company could be restored to its previous position, but because of "an obligation to set the record straight and clear the good name of the 28,000 innocent people who lost their jobs at the time of the indictment and protect the firm against a flood of civil lawsuits." In the summer of 2004, a federal appellate court unanimously denied Andersen's appeal of the conviction. Andersen then appealed to the United States Supreme Court, and on May 31, 2005, in a 9–0 decision, the Court overturned the 2002 criminal conviction of Andersen. The Supreme Court indicated that the judge's instructions to the Texas jury in the 2002 trial "were too broad . . . and could result in the criminalization of innocent conduct." Although Andersen could be retried, would there be any point to doing so? "The company that once boasted 28,000 employees is now home to fewer than 200. It long ago relinquished its accounting license and no longer conducts public audits." As was observed in *The Economist*, "[I]t is pointless to go on hounding a firm that is but a shell of its former

self, consisting of a couple of hundred people fighting lingering lawsuits.”

The United States Justice Department described the Supreme Court’s decision as disappointing, and Acting Assistant Attorney General John Richter said prosecutors “remained convinced that even the most powerful corporations have the responsibility of adhering to the rule of law.” Nonetheless, in November 2005 the Justice Department announced that it would not retry Arthur Andersen. In a filing with the 5th U.S. Circuit Court of Appeals in New Orleans, Justice Department officials argued it was “in the interests of justice not to re-prosecute (Arthur) Andersen on the pending charge.”

### Questions for Discussion

1. Would you ever destroy electronic or paper records to eliminate evidence that might be used against you? Why or why not?
2. What is the logic of indicting an entire company for ethical failures rather than indicting only the responsible individuals?
3. Do you think the Appellate Court’s reversal of the District Court’s decision was appropriate? Explain your answer.
4. Do you think the destruction of Andersen as a company was justified? Why or why not?

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# 3

## ETHICAL PRINCIPLES, QUICK TESTS, AND DECISION-MAKING GUIDELINES

### 3.1 Ethical Dilemmas, Decision Criteria, Moral Creativity, and Ethical Reasoning

Ethical Insight 3.1

### 3.2 Levels and Types of Ethical Issues and Dilemmas

### 3.3 Utilitarianism: A Consequentialist (Results-Based) Approach

### 3.4 Universalism: A Deontological (Duty-Based) Approach

### 3.5 Rights: A Moral and Legal Entitlement-Based Approach

### 3.6 Justice: Procedures, Compensation, and Retribution

### 3.7 Virtue Ethics: Character-Based Virtues

### 3.8 The Common Good

### 3.9 Ethical Relativism: A Self-Interest Approach

### 3.10 Immoral, Amoral, and Moral Management

### 3.11 Four Social Responsibility Roles

### 3.12 Individual Ethical Decision-Making Styles

### 3.13 Quick Ethical Tests

### 3.14 Concluding Comments

### Chapter Summary

### End-of-Chapter Questions and Exercises

### Real-Time Ethical Dilemma

### Cases

Samuel Waksal and ImClone

Aaron Feuerstein and Malden Mills:  
How Values Guided Actions in a  
Post-Crisis Situation

Jerome Kerviel: Rogue Trader  
or Misguided Employee

Seeking Two Kinds of Green: Richard  
Branson's Venture into Biofuels

Ford's Pinto Fires: The Retrospective  
View of Ford's Field Recall  
Coordinator

## OPENING CASE

Louise Simms, newly graduated with a master of business administration (MBA) degree, was hired by a prestigious multinational firm based in the United States. With minimal training, she was sent to join a company partner

to negotiate with a high-ranking Middle Eastern government official. The partner informed Simms that he would introduce her to the government contact and then leave her to "get the job done." Her assignment was to

"do whatever it takes to win the contract: it's worth millions to us." The contract would enable Simms' firm to select and manage technology companies that would install a multi-million-dollar computer system for that government. While in the country, Simms was told by the official that Simms' firm had "an excellent chance of getting the contract" if the official's nephew, who owned and operated a computer company in that country, could be assured "a good piece of the action."

On two different occasions, while discussing details, the official attempted unwelcome advances toward Simms. He backed off both times when he observed her subtle negative responses. Simms was told that "the deal" would remain a confidential matter and the official closed by saying, "That's how we do business here; take it or leave it."

Simms was frustrated about the terms of the deal and about the advances toward her. She called her superior in Chicago and urged him not to accept these conditions because of the questionable arrangements and also because of the disrespect shown toward her, which she said reflected on the company as well. Simms' supervisor responded, "Take the deal! And don't let your emotions get involved. You're in another culture. Go with the flow. Accept the offer and get the contract groundwork started. Use your best judgment on how to handle the details."

Simms couldn't sleep that night. She now had doubts about her supervisor's and the government administrator's ethics. She felt that she had conflicting priorities. This was her first job and a significant opportunity. At the same time, she had to live with herself.

### 3.1 ETHICAL DILEMMAS, DECISION CRITERIA, MORAL CREATIVITY, AND ETHICAL REASONING

An ethical dilemma is a problem or issue that confronts a person, group or organization and that requires a decision or choice among competing claims and interests, all of which may be unethical (i.e., against all parties' principles). Decision choices presented by an ethical dilemma usually involve solutions that do not satisfy all stakeholders. In some situations, there may be a resolution to an ethical dilemma that is the "right" thing to do, although none of the stakeholders' material interests are benefitted. Ethical dilemmas that involve many stakeholders require a reasoning process that clearly states the dilemma objectively, and then proceeds to articulate the issues and different solution alternatives.

Although ethical reasoning has been defined, in part, by acting on "principled thinking," it is also true that moral creativity, negotiating skills, and knowing your values also help solve tough "real world" situations. Should Louise Simms move to close the lucrative deal or not? Is the official offering her a bribe? What other personal, as well as professional, obligations would she be committing herself to if she accepted? Is the official's request legal? Is it ethical? Is this a setup? If so, who is setting her up? Would Louise be held individually responsible if something went wrong? Who is going to protect her if legal complications arise? How is she supposed to negotiate such a deal? What message is she sending about herself as well as her company?

What if she is asked to return and work with these people if the contract is signed? What does Louise stand to win and lose if she does or does not accept the official's offer?

So, what *should* Louise do to act morally responsible in this situation? Is she acting only on behalf of her company or also from her own integrity and beliefs? These are the kinds of questions and issues this chapter addresses. No easy answers may exist, but understanding principles, sharing ethical dilemmas and outcomes, discussing ethical experiences in depth, and using role play to analyze situations can help you identify, think, and feel through the issues that underlie ethical dilemmas. Louise might refer to the "Ethical Insights" assessment in the box below to gauge her own motives.

The Louise Simms scenario may be complicated by the international context. This is a good starting point for a chapter on ethics, because business transactions now increasingly involve international players and different "rules of engagement." Chapter 8, on the global environment and stakeholder issues peculiar to multinational corporations, offers additional guidelines for solving dilemmas in international contexts. Deciding what is right and wrong in an international context also involves understanding laws and customs, and the level of economic, social, and technological development of the nation or region involved. For example, do European and U.S. standards of doing business in other countries carry certain biases? Would these biases result in consequences that are beneficial or harmful to those in the local culture? On the other hand, we should not easily accept stereotypical descriptions of how to do business by means of what may be considered "local customs."

### ETHICAL INSIGHT 3.1

#### Complete the following steps:

##### Step 1

Describe an ethical dilemma that you recently experienced. Be detailed: What was the situation? Who did it involve? Why? What happened? What did you do? What did you not do? Describe your reasoning process in taking or not taking action. What did others do to you? What was the result?

##### Step 2

Read the descriptions of relativism, utilitarianism, universalism, rights,

justice, and moral decision making in this chapter. Explain which principle best describes your reasoning and your action(s) in the dilemma you presented in Step 1.

##### Step 3

Were you conscious that you were reasoning and acting on these (or other) ethical principles before, during, and after your ethical dilemma? Explain.

##### Step 4

After reading this chapter, would you have acted any differently in your dilemma than you did? Explain.

### 3.2 LEVELS AND TYPES OF ETHICAL ISSUES AND DILEMMAS

The 2007 National Business Ethics Survey offers a projected list of three types of risk (faced by employees and companies) associated with different types of misconduct that can result in ethical dilemmas. The risk is organized into three categories: “severe risk (happens frequently and usually goes unreported), high risk (happens often and often goes unreported), and guarded risk (happens less frequently and may go unreported).”<sup>1</sup> Figure 3.1 on the next page illustrates this updated misconduct list associated with the three risk categories.

Ethical issues and dilemmas result from **pressures** that are experienced at four levels. The different types of ethical issues and potential dilemmas shown in Figure 3.1 can occur at any or all of the four levels identified here: (1) **the individual level**, (2) **the company or organizational level**, (3) **the industry level**, and (4) **the societal, international, and global level**.

1. At the *individual or professional level*: As the opening example of Louise illustrates, a person experiences pressures from conflicting demands or circumstances that require a decision. Ethical dilemmas at this level can occur as a result of workplace pressures or from personal circumstances or motivations not related to work. Pressures on Louise stem from a supervisor’s assignment, the consequences of which could affect others in the organization and possibly in the host culture. Is Louise being lied to? Is she being pressured to risk her integrity and even job or career by accepting this assignment? Note that what begins as an individual or personal dilemma can escalate into organizational and other levels, as is possible with Louise if the issues are not resolved.
2. At the *organizational level*: Firms that engage in questionable practices and activities face possible dilemmas with their stakeholders and/or stockholders. For example, American Airlines had to ground 1,000 flights in April of 2008 in order to inspect and “in some cases reattach wiring bundles in the wheel wells of its 300-plane fleet of MD-80s.” In fact, “American had inspected the wiring bundles and thought it had the problem fixed two weeks ago. But the FAA [Federal Aviation Administration], upon looking at the planes earlier this week, found some bundles were wrapped and attached to the wheel wells incorrectly, and ordered them redone. This was the largest airline grounding in American’s history; thousands of passengers were potentially put at high risk with unsafe and low quality of services—in this case, the risk of physical harm or even death.”<sup>2</sup>

In *Dukes v. Wal-Mart*, “The largest sexual discrimination lawsuit in U.S. history was brought against Wal-Mart when a federal appeals court approved class-action status for seven women who claim the retailer was biased in pay and promotions.” Plaintiffs in that case estimated that 1.5 million women who had worked for Wal-Mart in the U.S. stores since 1998 were eligible to join that suit. Wal-Mart’s reputation

and image will not be easily repaired from this and other lawsuits that have recently been brought against the largest retailer. Going forward, Wal-Mart’s officers must decide whether or not this type of possible discrimination is worth the legal, social, and media fall-out for the company and its stakeholders.<sup>3</sup> Examples of ethical issues that can result in dilemmas that companies face are:

- 3. At the *industry level*: Company officers, managers, and professionals may be influenced by and contribute to specific business practices in the industry. In the opening case, Louise can inquire about contract negotiation practices and expectations in her industry, but she still needs to examine her organization’s, profession’s, and individual ethics with regard to the instructions she has been given. Not all business practices that occur in an industry are ethical—or even legal. The subprime lending crisis illustrates how different organizations across industries violated ethical standards.
- 4. *The societal, international, and global level*. Industry, organizational, professional, and personal ethics may clash at the societal, global, and international levels. For example, while tipping and paying money to government and other business officials in some countries may meet customary practices, such offerings may also be illegal bribes in other countries (like the U.S. and Europe). Louise is walking a tight rope in her decision. She needs to consult the Foreign Corrupt Practices Act (discussed in Chapter 8) to determine whether or not her superiors are asking her personally and professionally—as a representative of her firm—to act illegally.

Figure 3.1

Ethical Issues and Potential Dilemmas in Corporations

Severe Risks	High Risks	Guarded Risks
<ul style="list-style-type: none"><li>• Putting own interests ahead of organization</li><li>• Lying to employees</li><li>• Abusive behavior</li></ul>	<ul style="list-style-type: none"><li>• Stealing/Internet abuse</li><li>• Misreporting hours worked</li><li>• Lying to stakeholders</li><li>• Discrimination</li><li>• Safety violations</li><li>• Improper hiring practices</li><li>• Sexual harassment</li><li>• Provision of low quality goods and services</li></ul>	<ul style="list-style-type: none"><li>• Environmental violations</li><li>• Misuse of confidential organizational information</li><li>• Alteration of documents</li><li>• Alteration of financial records</li><li>• Using competitors’ inside information</li></ul>

**SOURCE:** 2007 National Business Ethics Survey, Ethics Resource Center’s NATIONAL BUSINESS ETHICS SURVEY. Copyright, p. 8 2007 Ethics Resource Center. All rights reserved. Printed in the United States of America. Written permission from the Ethics Resource Center, 2345 Crystal Drive, Suite 201, Arlington, VA 22202 USA. Additional copies of this report and more information about permission and licensing may be obtained by calling 703-647-2185, or by visiting [www.ethics.org](http://www.ethics.org).



## Moral Creativity

Moral Creativity or imagination relates to the need for and skill of recognizing the complexity of some ethical dilemmas that involve interlocking, conflicting interests, and relationships from the point of view of the person, group, and/or organization facing a decision to be made. Creativity is required to gain perspective among the different stakeholders and their interests to sort out and evaluate harmful effects among different alternative actions.<sup>4</sup> What begins as a business-as-usual decision can evolve into a dilemma or even a “defining moment” in one’s life.<sup>5</sup>

An ethical decision typically involves choosing between two options: one we know to be right and another we know to be wrong. A defining moment, however, challenges us in a deeper way by asking us to choose between two or more ideals in which we deeply believe. Such challenges rarely have a “correct” response. Rather, they are situations created by circumstance that ask us to step forward and, in the words of the American philosopher John Dewey, “form, reveal, and test” ourselves. We form our character when we commit to irreversible courses of action that shape our personal and professional identities. We reveal something new about us to ourselves and others because defining moments uncover something that had been hidden or crystallize something that had been only partially known. And we test ourselves because we discover whether we will live up to our personal ideals or only pay them lip service.<sup>6</sup>

Joseph Badaracco at Harvard University offers three key questions with creative probes for individuals, work group managers, and company executives to address before acting in a “defining moment.” For individuals, the key question is “*Who am I?*” This question requires individuals to:

1. Identify their feelings and intuitions that are emphasized in the situation.
2. Identify their deepest values in conflict brought up by the situation.
3. Identify the best course of action to understand the right thing to do.<sup>7</sup>

Work group managers can ask, “Who are we?” They can also address these three dimensions of the team and situation:

1. What strong views and understanding of the situation do others have?
2. Which position or view would most likely win over others?
3. Can I coordinate a process that will reveal the values I care about in this organization?

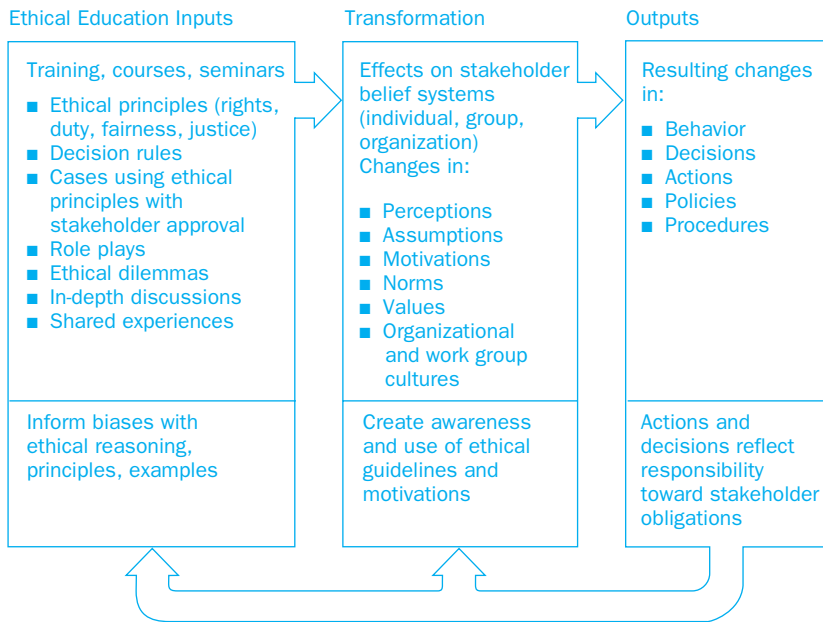
Company executives can ask, “*Who is the company?*” Three questions they can consider are:

1. Have I strengthened my position and the organization to the best of my ability?
2. Have I considered my organization’s role vis-à-vis society and shareholders boldly and creatively?
3. How can I transform my vision into action, combining creativity, courage, and shrewdness?

All professionals should ask the three sets of questions to help articulate a morally creative response to ethical dilemmas and “defining moments.” What would have happened differently had the following CEOs reflected on these three sets of questions: Enron’s Jeffrey Skilling and Ken Lay,

Figure 3.2

### Intended Effects of Business Ethics Education on Stakeholder Belief Systems and Decisions



**SOURCE:** Copyright Joseph W. Weiss, Bentley College, Waltham, MA, 2005.

Tyco's Dennis Kozlowski, Sam Waksal at ImClone, Gary Winnick at Global Crossing, and Martha Stewart at Martha Stewart Living Omnimedia?

The aim of this chapter is to present a range of decision-making resources that can help you evaluate moral responsibilities when resolving ethical dilemmas (Figure 3.2). Change begins with having an awareness that can help build confidence by perceiving dilemmas before they are played out and assisting you in negotiating solutions with a moral dimension.

## 12 Questions to Get Started

A first step in addressing ethical dilemmas is to identify the problem. This is particularly necessary for a stakeholder approach, because the problems depend on who the stakeholders are and what their stakes entail. Before specific ethical principles are discussed, let's begin by considering important decision criteria for ethical reasoning. How would you apply the criteria to Louise Simms' situation?

Twelve questions, developed by Laura Nash,<sup>8</sup> to ask yourself during the decision-making period are:

1. Have you defined the problem accurately?
2. How would you define the problem if you stood on the other side of the fence?

3. How did the situation occur?
4. To whom and to what do you give your loyalty as a person and as a member of the corporation?
5. What is your intention in making this decision?
6. How does this intention compare with the probable results?
7. Who could your decision injure?
8. Can you discuss the problem with the affected parties before you make your decision?
9. Are you confident that your decision will be valid over a long period?
10. Could you disclose, without qualm, your decision?
11. What is the symbolic potential of your action if understood? If misunderstood?
12. Under what conditions would you allow exceptions?

These 12 questions can help individuals openly discuss the responsibilities necessary to solve ethical problems. Sharing these questions can facilitate group discussions, build consensus around shared points, serve as an information source, uncover ethical inconsistencies in a company's values, help a CEO see how senior managers think, and increase the nature and range of choices. The discussion process is cathartic.

To return briefly to the opening case, if Louise Simms considered the first question, she might, for example, define the problem she faces from different perspectives (as discussed in Chapter 1). At the *organizational* level, her firm stands to win a sizable contract if she accepts the government official's conditions. Yet her firm's reputation could be jeopardized in the United States if this deal turned out to be a scandal. At the *societal* level, the issues are complicated. In this Middle Eastern country, this type of bargaining might be acceptable. In the United States, however, Louise could have problems with the Foreign Corrupt Practices Act. At the *individual* level, she must decide if her conscience can tolerate the actions and consequences this deal involves. As a woman, she may be at risk because advances were made toward her. Her self-esteem and integrity have also been damaged. She must consider the costs and benefits that she will incur from her company if she decides to accept or reject this assignment. As you can see, these questions can help Louise clarify her goal of making a decision and determine the price she is willing to pay for that decision.

### Three Criteria in Ethical Reasoning

The following criteria can be used in ethical reasoning. They help to systematize and structure our arguments:<sup>9</sup>

1. Moral reasoning must be logical. Assumptions and premises, both factual and inferred, used to make judgments should be known and made explicit.
2. Factual evidence cited to support a person's judgment should be accurate, relevant, and complete.

3. Ethical standards used in reasoning should be consistent. When inconsistencies are discovered in a person's ethical standards in a decision, one or more of the standards must be modified.

If Louise Simms were to use these three criteria, she would articulate the assumptions underlying her decision. If she chose to accept the official's offer, she might reason that she assumed it was not a bribe, that if it were a bribe she assumed she would not get caught, and that even if she or her company did get caught, she would be willing to incur any penalty individually, including the loss of her job. Moreover, Louise would want to obtain as many facts as she could about the U.S. laws and the Middle Eastern country's laws on negotiating practices. She would gather information from her employer and check the accuracy of the information against her decision.

She would have to be consistent in her standards. If she chooses to accept the foreign official's conditions, she must be willing to accept additional contingencies consistent with those conditions. She could not suddenly decide that her actions were "unethical" and then back out midway through helping the official's nephew obtain part of the contract. She must think through these contingencies *before* she makes a decision.

Finally, a simple but powerful question can be used throughout your decision-making process: "What is my motivation for choosing a course of action?" Examining individual motives and separating these from the known motivations of others provides clarity and perspective. Louise, for example, might ask, "Why did I agree to negotiate with the official on his terms? Was it for money? To keep my job? To impress my boss? For adventure?" She also might ask whether her stated motivation from the outset would carry her commitments through the entire contracting process.

## Moral Responsibility

A major aim of ethical reasoning is to gain a clear focus on problems to facilitate acting in morally responsible ways. Individuals are morally responsible for the harmful effects of their actions when (1) *they knowingly and freely acted or caused the act to happen and knew that the act was morally wrong or hurtful to others* and (2) *they knowingly and freely failed to act or prevent a harmful act, and they knew it would be morally wrong for a person to do this*.<sup>10</sup> Although no universal definition of what constitutes a morally wrong act exists, an act and the consequences of an act can be defined as morally wrong if physical or emotional harm is done to another as a result of the act.

Two conditions that eliminate a person's moral responsibility for causing injury or harm are *ignorance* and *inability*.<sup>11</sup> However, persons who intentionally prevent themselves from knowing that a harmful action will occur are still responsible. Persons who negligently fail to inform themselves about a potentially harmful matter may still be responsible for the resultant action. Of course, some mitigating circumstances can excuse or lessen a person's moral responsibility in a situation. These include circumstances that show: (1) *a low level of or lack of seriousness to cause harm*, (2) *uncertainty about knowledge of wrongdoing*, and (3) *the degree to which a harmful injury*

*was caused or averted.* As we know from court trials, proving intent for an alleged illegal act is not an easy matter. Similarly, the extent to which a person is morally irresponsible can be difficult to determine. For example, should Bill Gates and Steve Ballmer consider that outsourcing work might hurt U.S.-based employees? Are tobacco executives morally responsible for the deaths cigarette smoking causes in international countries as well as in the U.S.? Did DuPont know that a certain chemical used in Teflon is dangerous to consumers' health? What principles and standards can we use to establish moral responsibility for ourselves and others?

In the following sections, five fundamental ethical principles that can be used in ethical reasoning are discussed (Figure 3.3). The principles are: (1) utilitarianism, (2) universalism, (3) rights, (4) justice, and (5) ethical virtue. In addition, four social responsibility modes and four individual styles of ethical reasoning are presented. Finally, some “quick ethical tests” are provided, which you may use to clarify ethical dilemmas.

### 3.3 UTILITARIANISM: A CONSEQUENTIALIST (RESULTS-BASED) APPROACH

Jeremy Bentham (1748–1832) and John Stuart Mill (1806–1873) are acknowledged as founders of the concept of *utilitarianism*. Although various interpretations of the concept exist, the basic utilitarian view holds that an action is judged as right or good on the basis of its consequences. The ends of an action justify the means taken to reach those ends. As a *consequentialist principle*, the moral authority that drives utilitarianism is the calculated *consequences*, or results, of an action, regardless of other principles that determine the means or motivations for taking the action. Utilitarianism also includes the following tenets:<sup>12</sup>

1. An action is morally right if it produces the greatest good for the greatest number of people.
2. An action is morally right if the net benefits over costs are greatest for all affected compared with the net benefits of all other possible choices.
3. An action is morally right if its benefits are greatest for each individual and if these benefits outweigh the costs and benefits of the alternatives.

There are also two types of criteria used in utilitarianism: *rule based*<sup>13</sup> and *act based*.<sup>14</sup> *Rule-based* utilitarianism argues that general principles are used as criteria for deciding the greatest benefit to be achieved from acting a certain way. The act itself is not the basis used for examining whether the greatest good can be gained. For example, “stealing is not acceptable” could be a principle that rule-based utilitarians would follow to gain the greatest utility from acting a certain way. “Stealing is not acceptable” is not an absolute principle that rule-based utilitarians would follow in every situation. Rule-based utilitarians might choose another principle over “stealing is not acceptable” if the other principle provided a greater good. *Act-based* utilitarians, on the other hand, analyze a particular action or behavior to determine whether the greatest utility or good can be achieved. Act-based

Figure 3.3

### Summary of Five Ethical Decision-Making Principles with the Stakeholder Analysis

Belief Systems	Source of Moral Activity	Stakeholder Analysis Issues
Utilitarianism (Calculation of Costs and Benefits)	Moral authority is determined by the consequences of an act: An act is morally right if the net benefits over costs are greatest for the majority. Also, the greatest good for the greatest number must result from this act.	<ol style="list-style-type: none"> <li>1. Consider collective as well as particular interests.</li> <li>2. Formulate alternatives based on the greatest good for all parties involved.</li> <li>3. Estimate costs and benefits of alternatives for groups affected.</li> </ol>
Universalism (Duty)	Moral authority is determined by the extent to which the intention of an act treats all persons with respect. Includes the requirement that everyone would act this way in the same circumstances.	<ol style="list-style-type: none"> <li>1. Identify individuals whose needs and welfare are at risk with a given policy or decision.</li> <li>2. Identify the use or misuse of manipulation, force, coercion, or deceit that may be harmful to individuals.</li> <li>3. Identify duties to individuals affected by the decision.</li> <li>4. Determine if the desired action or policy would be acceptable to individuals if the decision were implemented.</li> </ol>
Rights (Individual Entitlement)	Moral authority is determined by individual rights guaranteed to all in their pursuit of freedom of speech, choice, happiness, and self-respect.	<ol style="list-style-type: none"> <li>1. Identify individuals and their rights that may be violated by a particular action.</li> <li>2. Determine the legal and moral basis of these individual rights.</li> <li>3. Determine the moral justification from utilitarian principles if individuals' rights are violated.</li> </ol>
Justice (Fairness and Equity)	Moral authority is determined by the extent opportunities, wealth, and burdens are fairly distributed among all.	<ol style="list-style-type: none"> <li>1. If a particular action is chosen, how equally will costs and benefits be distributed to stakeholders?</li> <li>2. How clear and fair are the procedures for distributing the costs and benefits of the decision?</li> <li>3. How can those who are unfairly affected by the action be compensated?</li> </ol>
Ethical Virtue Perspective (Character-Based Ethic)	Moral authority is based on individual character virtues such as truthfulness, integrity, honesty. An act, policy, strategy is moral if it reflects these types of virtues.	<ol style="list-style-type: none"> <li>1. What are the 'character virtues' of the individual stakeholder(s), the policy, procedure, or strategy in question?</li> <li>2. If a particular action, policy, strategy is chosen, to what extent will these virtues be evident, or missing?</li> <li>3. While seeking a mutually desirable outcome in a conflicting situation, how can conflicting character values and characteristics that are embedded and/or reflected in a decision, policy or strategy be avoided or negotiated?</li> </ol>

**SOURCE:** Copyright Joseph W. Weiss, Bentley College, Waltham, MA, 2005.

utilitarians might also choose an action over a principle if the greatest utility could be gained. For example, an employee might reason that illegally removing an untested chemical substance from company storage would save the lives of hundreds of infants in a less-advantaged country because that chemical is being used in an infant formula manufactured in that country. The employee could lose his job if caught; still he calculates that stealing the chemical in this situation provides the greatest utility.

Utilitarian concepts are widely practiced by government policy makers, economists, and business professionals. Utilitarianism is a useful principle for conducting a stakeholder analysis, because it forces decision makers to (1) consider collective as well as particular interests, (2) formulate alternatives based on the greatest good for all parties involved in a decision, and (3) estimate the costs and benefits of alternatives for the affected groups.<sup>15</sup>

Louise Simms would use utilitarian principles in her decision making by identifying each of the stakeholders who would be affected by her decision. She would then calculate the costs and benefits of her decision as they affect each group. Finally, she would decide on a course of action based on the greatest good for the greatest number. For example, after identifying all the stakeholders in her decision, including her own interests, Simms might believe that her firm's capabilities were not competitive and that rejecting the offer would produce the greatest good for the people of the country where the contract would be negotiated, because obtaining bids from the most technically qualified companies would best serve the interests of those receiving the services.

Problems with utilitarianism include the following:

1. No agreement exists about the definition of "good" for all concerned. Is it truth, health, peace, profits, pleasure, cost reductions, or national security?<sup>16</sup>
2. No agreement exists about who decides. Who decides what is good for whom? Whose interests are primary in the decisions?
3. The actions are not judged, but rather their consequences. What if some actions are simply wrong? Should decision makers proceed to take those actions based only on their consequences?
4. How are the costs and benefits of nonmonetary stakes, such as health, safety, and public welfare, measured? Should a monetary value be assigned to nonmarketed benefits and costs?<sup>17</sup> What if the actual or even potentially harmful effects of an action cannot be measured in the short term, but the action is believed to have potentially long-term effects, say in 20 or 30 years? Should that action be chosen?
5. Utilitarianism does not consider the individual. It is the collective for whom the greatest good is estimated. Do instances exist when individuals and their interests should be valued in a decision?
6. The principles of justice and rights are ignored in utilitarianism. The principle of justice is concerned with the distribution of good, not the amount of total good in a decision. The principle of rights is concerned with individual entitlements, regardless of the collective calculated benefits.

Even given these problems, the principle of utilitarianism is still valuable under some conditions: when resources are fixed or scarce; when priorities are in conflict; when no clear choice fulfills everyone's needs; and when large or diverse collectives are involved in a zero-sum decision, i.e., when a gain for some corresponds to a loss for others.<sup>18</sup>

## Utilitarianism and Stakeholder Analysis

Because businesses use utilitarian principles when conducting a stakeholder analysis, you, as a decision maker, should:

1. Define how costs and benefits will be measured in selecting one course of action over another—including social, economic, and monetary costs and benefits as well as long-term and short-term costs and benefits. On what principle, if any, would you use to base your utilitarian analysis?
2. Define what information you will need to determine the costs and benefits for comparisons.
3. Identify the procedures and policies you will use to explain and justify your cost-benefit analysis.
4. State your assumptions when defining and justifying your analysis and conclusions.
5. Ask yourself what moral obligations you have toward each of your stakeholders after the costs and benefits have been estimated.

## 3.4 UNIVERSALISM: A DEONTOLOGICAL (DUTY-BASED) APPROACH

Immanuel Kant (1724–1804) is considered one of the leading founders of the principle of *universalism*. Universalism, which is also called “deontological ethics,” holds that the ends do not justify the means of an action—the right thing must always be done, even if doing the wrong thing would do the most good for the most people. Universalism, therefore, is also referred to as a *nonconsequentialist* ethic. The term “deontology” is derived from the Greek word *deon*, or duty. Regardless of consequences, this approach is based on universal principles, such as justice, rights, fairness, honesty, and respect.<sup>19</sup>

Kant's principle of the *categorical imperative*, unlike utilitarianism, places the moral authority for taking action on an individual's duty toward other individuals and “humanity.” The categorical imperative consists of two parts. The first part states that *a person should choose to act if and only if she or he would be willing to have every person on earth, in that same situation, act exactly that way*. This principle is absolute and allows for no qualifications across situations or circumstances. The second part of the categorical imperative states that, in an ethical dilemma, *a person should act in a way that respects and treats all others involved as ends as well as means to an end*.<sup>20</sup>



Kant's categorical imperative forces decision makers to take into account their duty to act responsibly and respectfully toward all individuals in a situation. Individual human welfare is a primary stake in any decision. Decision makers must also consider formulating their justifications as principles to be applied to everyone.

In Louise Simms' situation, if she followed deontological principles of universalism, she might ask, "If I accept the official's offer, could I justify that anyone anywhere would act the same way?" Or, "Since I value my own self-respect and believe my duty is to uphold self-respect for others, I will not accept this assignment because my self-respect has been and may again be violated."

The major weaknesses of universalism and Kant's categorical imperative include these criticisms: First, these principles are imprecise and lack practical utility. It is difficult to think of all humanity each time one must make a decision in an ethical dilemma. Second, it is hard to resolve conflicts of interest when using a criterion that states that all individuals must be treated equally. Degrees of differences in stakeholders' interests and relative power exist. However, Kant would remind us that the human being and his or her humanity must be considered above the stakes, power bases, or consequences of our actions. Still, it is often impractical not to consider other elements in a dilemma. Finally, what if a decision-maker's duties conflict in an ethical dilemma? The categorical imperative does not allow for prioritizing. A primary purpose of the stakeholder analysis is to prioritize conflicting duties. It is, again, difficult to take absolute positions when limited resources and time and conflicting values are factors.

## Universalism and Stakeholder Analysis

The logic underlying universalism and the categorical imperative can be helpful for applying a stakeholder analysis. Even though we may not be able to employ Kant's principles absolutely, we can consider the following as guidelines for using his ethics:

Take into account the welfare and risks of all parties when considering policy decisions and outcomes.

1. Identify the needs of individuals involved in a decision, the choices they have, and the information they need to protect their welfare.
2. Identify any manipulation, force, coercion, or deceit that might harm individuals involved in a decision.
3. Recognize the duties of respecting and responding to individuals affected by particular decisions before adopting policies and actions that affect them.
4. Ask if the desired action would be acceptable to the individuals involved. Under what conditions would they accept the decision?
5. Ask if individuals in a similar situation would repeat the designated action or policy as a principle. If not, why not? And would they continue to employ the designated action?

### 3.5 RIGHTS: A MORAL AND LEGAL ENTITLEMENT-BASED APPROACH

Rights are based on several sources of authority.<sup>21</sup> Legal rights are entitlements that are limited to a particular legal system and jurisdiction. In the United States, the Constitution and Declaration of Independence are the basis for citizens' legal rights—e.g., the right to life, liberty, and the pursuit of happiness, and the right to freedom of speech. *Moral* (and *human*) *rights*, on the other hand, are universal and based on norms in every society—e.g., the right not to be enslaved and the right to work.

Moral and legal rights are linked to individuals, and in some cases, groups, not to societies, as is the case with a utilitarian ethic. Moral rights are also connected with duties, i.e., my moral rights imply that others have a duty toward me to not violate those rights, and vice versa. Moral rights also provide the freedom to pursue one's interests, as long as those interests do not violate others' rights. Moral rights also allow individuals to justify their actions and seek protection from others in doing so.

There are also special rights and duties, or *contractual rights*. Contracts provide individuals with mutually binding duties that are based on a legal system with defined transactions and boundaries. Moral rules that apply to contracts include: (1) the contract should not commit the parties to unethical or immoral conduct; (2) both parties should freely and without force enter the contractual agreement; (3) neither individual should misrepresent or misinterpret facts in the contract; and (4) both individuals should have complete knowledge of the nature of the contract and its terms before they are bound by it.<sup>22</sup>

Finally, the concept of *negative* and *positive rights* defines yet another dimension of ethical principles.<sup>23</sup> A *negative right* refers to the duty others have to not interfere with actions related to a person's rights. For example, if you have the right to freedom of speech, others—including your employer—have the duty not to interfere with that right. Of course there are circumstances that constrain “free speech” as we will discuss in Chapter 4. A *positive right* imposes a duty on others to provide for your needs to achieve your goals, not just protect your right to pursue them. Some of these rights may be part of national, state, or local legislation. For example, you may have the right to equal educational opportunities for your child if you are a parent. This implies that you have the right to send your child to a public school that has the same standards as any other school in your community.

Positive rights were given attention in the twentieth century. National legislation that promoted different groups' rights and the United Nations' Universal Declaration of Human Rights served as sources for positive rights. Negative rights were emphasized in the seventeenth and eighteenth centuries and were based on the Bill of Rights in the Declaration of Independence. Currently, American political parties and advocates who are either politically to the “left” or to the “right” debate on whether certain moral rights are “negative” or “positive” and to what extent taxpayers' dollars and government funds should support these rights. For example,

“conservative” writers like Milton Friedman<sup>24</sup> have endorsed government support of negative rights (like protecting property, and enforcing law and order) and argued against public spending on positive rights (like medical assistance, job training, and housing). As you can see, the concept of rights has several sources of moral authority. Understanding and applying the concept of rights to stakeholders in business situations adds another dimension of ethical discovery to your analysis.

Louise Simms might ask what her rights are in her situation. If she believes that her constitutional and moral rights would be violated by accepting the offer, she would consider refusing to negotiate on the foreign official’s terms.

The limitations of the principle of rights include:

1. The justification that individuals are entitled to rights can be used to disguise and manipulate selfish, unjust political claims and interests.
2. Protection of rights can exaggerate certain entitlements in society at the expense of others. Fairness and equity issues may be raised when the rights of an individual or group take precedence over the rights of others. Issues of reverse discrimination, for example, have arisen from this reasoning.
3. The limits of rights come into question. To what extent should practices that may benefit society, but threaten certain rights, be permitted?

## Rights and Stakeholder Analysis

The principle of rights is particularly useful in stakeholder analysis when conflicting legal or moral rights of individuals occur or when rights may be violated if certain courses of action are pursued. The following are guidelines for observing this principle:<sup>25</sup>

1. Identify the individuals whose rights may be violated.
2. Determine the legal and moral bases of these individuals’ rights. Does the decision violate these rights on such bases?
3. Determine to what extent the action has moral justification from utilitarian or other principles if individual rights may be violated. National crises and emergencies may warrant overriding individual rights for the public good.

## 3.6 JUSTICE: PROCEDURES, COMPENSATION, AND RETRIBUTION

The principle of *justice* deals with fairness and equality. Here, the moral authority that decides what is right and wrong concerns the fair distribution of opportunities, as well as hardships, to all. The principle of justice also pertains to punishment for wrong done to the undeserving. John Rawls (1971), a contemporary philosopher, offers two principles

of fairness that are widely recognized as representative of the principle of justice:<sup>26</sup>

1. Each person has an equal right to the most extensive basic liberties that are compatible with similar liberties for others.
2. Social and economic inequalities are arranged so that they are both (a) reasonably expected to be to everyone's advantage and (b) attached to positions and offices open to all.

The first principle states that all individuals should be treated equally. The second principle states that justice is served when all persons have equal opportunities and advantages (through their positions and offices) to society's opportunities and burdens. Equal opportunity or access to opportunity does not guarantee equal distribution of wealth. Society's disadvantaged may not be justly treated, some critics claim, when only equal opportunity is offered. The principle of justice also addresses the unfair distribution of wealth and the infliction of harm.

Richard DeGeorge identifies four types of justice:<sup>27</sup>

1. *Compensatory justice* concerns compensating someone for a past harm or injustice. For example, affirmative action programs, discussed in Chapter 6, are justified, in part, as compensation for decades of injustice that minorities have suffered.
2. *Retributive justice* means serving punishment to someone who has inflicted harm on another. A criterion for applying this justice principle is: "Does the punishment fit the crime?"
3. *Distributive justice* refers to the fair distribution of benefits and burdens. Have certain stakeholders received an unfair share of costs accompanying a policy or action? Have others unfairly profited from a policy?
4. *Procedural justice* designates fair decision practices, procedures, and agreements among parties. This criterion asks, "Have the rules and processes that govern the distribution of rewards, punishments, benefits, and costs been fair?"

These four types of justice are part of the larger principle of justice. How they are formulated and applied varies with societies and governmental systems.

Following the principle of justice, Louise Simms might ask whether accepting the government official's offer would provide a fair distribution of goods and services to the recipients of the new technological system. Also, are the conditions demanded by the government administrator fair for all parties concerned? If Simms determined that justice would not be served by enabling her company to be awarded the contract without a fair bidding process, she might well recommend that her firm reject the offer.

The obvious practical problems of using the principle of justice include the following: Outside the jurisdiction of the state and its judicial systems, where ethical dilemmas are solved by procedure and law, who decides who is right and who is wrong? Who has the moral authority to punish whom?

Can opportunities and burdens be fairly distributed to all when it is not in the interest of those in power to do so?

Even with these shortcomings, the principle of justice adds an essential contribution to the other ethical principles discussed so far. Beyond the utilitarian calculation of moral responsibility based on consequences, beyond the universalist absolute duty to treat everyone as a means and not an end, and beyond the principle of rights, which values unquestionable claims, the principle of justice forces us to ask how fairly benefits and costs are distributed, regardless of power, position, wealth.

## **Rights, Power, and “Transforming Justice”**

Justice, rights, and power are really intertwined. Rights plus power equals “transforming justice.” T. McMahon states, “While natural rights are the basis for justice, rights cannot be realized nor justice become operative without power;”<sup>28</sup> Judges and juries exercise power when two opposing parties, both of whom are “right,” seek justice from the courts.

Power generally is defined and exercised through inheritance, authority, contracts, competition, manipulation, and force. Power exercised through manipulation cannot be used to obtain justice legitimately. The two steps in exercising “transforming justice” are:

1. Be aware of your rights and power. McMahon states, “It is important to determine what rights and how much legitimate power are necessary to exercise these rights without trampling on other rights. For example, an employer might have the right and the power to fire an insolent employee, but she or he might not have enough to challenge union regulations.”<sup>29</sup>
2. Establish legitimate power as a means for obtaining and establishing rights. According to McMahon, “If the legitimacy of transforming justice cannot be established, its exercise may then be reduced to spurious power plays to get what someone wants, rather than a means of fulfilling fights.”<sup>30</sup>
3. This interrelationship of rights, justice, and power is particularly helpful in studying stakeholder management relationships. Since stakeholders exercise power to implement their interests, the concept of “rights plus power equals transforming justice” adds value in determining justice (procedural, compensatory, and retributive). The question of justice in complex, competitive situations becomes not only “Whose rights are more right?” but also “By what means and to what end was power exercised?”

## **Justice and Stakeholder Analysis**

In a stakeholder analysis, the principle of justice can be applied with these questions:

1. How equitable will the distribution of benefits and costs, pleasure and pain, and reward and punishment be among stakeholders if you pursue a particular course of action? Would all stakeholders’ self-respect be acknowledged?

2. How clearly have the procedures for distributing the costs and benefits of a course of action or policy been defined and communicated? How fair are these procedures to all affected?
3. What provisions can be made to compensate those who will be unfairly affected by the costs of the decision? What provisions can we make to redistribute benefits among those who have been unfairly or overly compensated by the decision?

### 3.7 VIRTUE ETHICS: CHARACTER-BASED VIRTUES

Plato and Aristotle are recognized as founders of virtue ethics, which also has roots in ancient Chinese and Greek philosophy. Virtue ethics emphasizes moral character in contrast to moral rules (deontology) or consequences of actions (consequentialism).<sup>31</sup>

Virtue ethics is grounded in “character traits,” that is, “a disposition which is well entrenched in its possessor, something that, as we say ‘goes all the way down’, unlike a habit such as being a tea-drinker—but the disposition in question, far from being a single track disposition to do honest actions, or even honest actions for certain reasons, is multi-track. It is concerned with many other actions as well, with emotions and emotional reactions, choices, values, desires, perceptions, attitudes, interests, expectations and sensibilities. To possess a virtue is to be a certain sort of person with a certain complex mindset. (Hence the extreme recklessness of attributing a virtue on the basis of a single action.)”<sup>32</sup>

The concepts of virtue ethics derived from ancient Greek philosophy are the following: virtue, practical wisdom, and eudaimonia (or happiness, flourishing, and well-being). Virtue ethics focuses on the type of person we ought to be, not on specific actions that should be taken. It is grounded in good character, motives, and core values. Virtue ethics argue that the possessor of good character is and acts moral, feels good, is happy, and flourishes. Practical wisdom, however, is often required to be virtuous. Adults can be culpable in their intentions and actions by being “thoughtless, insensitive, reckless, impulsive, shortsighted, and by assuming that what suits them will suit everyone instead of taking a more objective viewpoint. They are also, importantly, culpable if their understanding of what is beneficial and harmful is mistaken. It is part of practical wisdom to know how to secure real benefits effectively; those who have practical wisdom will not make the mistake of concealing the hurtful truth from the person who really needs to know it in the belief that they are benefiting him.”<sup>33</sup>

Critiques of virtue ethics include the following major arguments: “First, virtue ethics fails to adequately address dilemmas which arise in applied ethics, such as abortion. For, virtue theory is not designed to offer precise guidelines of obligation. Second, virtue theory cannot correctly assess the occasional tragic actions of virtuous people. . . . Since virtue theory focuses on the general notion of a good person, it has little to say about particular tragic acts. Third, some acts are so intolerable, such as murder, that we must devise a special list of offenses which are prohibited. Virtue theory

does not provide such a list. Fourth, character traits change, and unless we stay in practice, we risk losing our proficiency in these areas. This suggests a need for a more character-free way of assessing our conduct. Finally, there is the problem of moral backsliding. Since virtue theory emphasizes long-term characteristics, this runs the risk of overlooking particular lies, or acts of selfishness, on the grounds that such acts are temporary aberrations.”<sup>34</sup> These same criticisms also apply to other ethical principles and schools of thought.

## Virtue Ethics and Stakeholder Analysis

Virtue ethics adds an important dimension to rules and consequentialist ethics by contributing a different perspective for understanding and executing stakeholder management. Examining the motives and character of stakeholders can be helpful in discovering underlying motivations of strategies, actions, and outcomes in complex business and corporate transactions. With regard to corporate scandals, virtue ethics can explain some of the motives of several corporate officers’ actions that center on greed, extravagant habits, irrational thinking, and egotistical character traits.

Virtue ethics also adds a practical perspective. Beauchamp and Childress state, “A practical consequence of this view is that the education of, for example medical doctors, should include the cultivation of virtues such as compassion, discernment, trustworthiness, integrity, conscientiousness as well as benevolence (desire to help) and nonmalevolence (desire to avoid harm).”<sup>35</sup> These authors also note that “persons of ‘good character’ can certainly formulate ‘bad policy’ or make a ‘poor choice’—we need to evaluate those policies and choices according to moral principles.”

## 3.8 THE COMMON GOOD

Plato and Aristotle are believed to be the authors of the common good concept. The ethicist John Rawls has developed and redefined the notion of the *common good* as “certain general conditions that are...equally to everyone’s advantage.”<sup>36</sup> The common good has also been defined as “the sum of those conditions of social life which allow social groups and their individual members relatively thorough and ready access to their own fulfillment.”<sup>37</sup> The common good includes the broader interdependent institutions, social systems, environments, and services and goods. Examples of the common good include the health care system, legislative and judicial systems, political, economic, and legal systems, and the physical environment. These systems exist at the local, regional, national, and global levels. Individuals, groups, and populations are dependent on these interlocking systems.<sup>38</sup> The common good must be created and maintained in societies. Cooperative and collaborative effort is required. “The common good is a good to which all members of society have access, and from whose enjoyment no one can be easily excluded. All persons, for example, enjoy the benefits of clean air or

an unpolluted environment, or any of our society's other common goods. In fact, something counts as a common good only to the extent that it is a good to which all have access."<sup>39</sup>

The ethic of the common good suggests that decision makers take into consideration the intent as well as the effects of their actions and decisions on the broader society and the common good of the many. There are four major constraining factors and arguments on the notion of the common: (1) A unitary notion of the common good is not viable in a pluralistic society. The common good means different things to different people; (2) Relatedly, in an individualistic society, people are rewarded to provide and succeed by themselves. The logic of the common good runs counter in many instances to this individualist cultural orientation; (3) "Free riders" abuse the provision of the common good by taking advantage of the benefits while not contributing to the upkeep of common goods. A critical mass of free riders can and does destroy common goods, such as parts of the environment; (4) Finally, helping create and sustain common goods means unequal sharing of burdens and sacrifices by some groups, since not all groups will exert such efforts. Expecting some groups to support the common good while others will not is unjust, and perhaps impractical. Given these obstacles, the ethic of the common good calls us to share in a common vision of a society that benefits and is beneficial for all members, while respecting individual differences. Using this ethic in our decision making also calls us to take goals and actions that include others besides ourselves and our own interest into account. Such a logic is not just partly altruistic, but, in many circumstances, practical. We thrive when we breathe clean air, drink clean water, and can trust that the food we eat is not contaminated. This logic may also apply to business decisions that involve our customers and employees, as well as our neighbors, family members, and ourselves as members of a society as well as an organization. By using this principle, Louise would consider what good would be gained from actions taken not only for the professionals involved in her company and the client's, but also for the host society. She would have to evaluate ethical principles that serve the common good and benefits of the people in that country.

### 3.9 ETHICAL RELATIVISM: A SELF-INTEREST APPROACH

**Ethical relativism** holds that no universal standards or rules can be used to guide or evaluate the morality of an act. This view argues that people set their own moral standards for judging their actions. Only the individual's self-interest and values are relevant for judging his or her behavior. This form of relativism is also referred to as *naïve relativism*.

Individuals, professionals, and organizations using this approach can consider finding out what the industry and/or professional standard or norm is with regard to an issue. Another suggestion would be to inflict no undue harm with a course of action taken.<sup>40</sup>



If Louise Simms were to adopt the principle of ethical relativism for her decision making, she might choose to accept the government official's offer to promote her own standing in his firm. She might reason that her self-interest would be served best by making any deal that would push her career ahead. But Simms could also use ethical relativism to justify her rejection of the offer. She might say that any possible form of such a questionable negotiation is against her beliefs. The point behind this principle is that individual standards are the basis of moral authority.

The logic of ethical relativism also extends to cultures. *Cultural relativism* argues that "when in Rome, do as the Romans do." What is morally right for one society or culture may be wrong for another. Moral standards vary from one culture to another. Cultural relativists would argue that firms and business professionals doing business in a country are obliged to follow that country's laws and moral codes. A criterion that relativists would use to justify their actions would be: "Are my beliefs, moral standards, and customs satisfied with this action or outcome?"

The benefit of ethical and cultural relativism is that they recognize the distinction between individual and social values and customs. These views take seriously the different belief systems of individuals and societies. Social norms and mores are seen in a cultural context.

However, relativism can lead to several problems. (It can be argued that this perspective is actually not ethical.) First, these views imply an underlying laziness.<sup>41</sup> Individuals who justify their morality only from their personal beliefs, without taking into consideration other ethical principles, may use the logic of relativism as an excuse for not having or developing moral standards. Second, this view contradicts everyday experience. Moral reasoning is developed from conversation, interaction, and argument. What I believe or perceive as "facts" in a situation may or may not be accurate. How can I validate or disprove my ethical reasoning if I do not communicate, share, and remain open to changing my own standards?

Ethical relativism can create absolutists—individuals who claim their moral standards are right regardless of whether others view the standards as right or wrong. For example, what if my beliefs conflict with yours? Whose relativism is right then? Who decides and on what grounds? In practice, ethical relativism does not effectively or efficiently solve complicated conflicts that involve many parties because these situations require tolerating doubts and permitting our observations and beliefs to be informed.

Cultural relativism embodies the same problems as ethical relativism. Although the values and moral customs of all cultures should be observed and respected, especially because business professionals are increasingly operating across national boundaries, we must not be blindly absolute or divorce ourselves from rigorous moral reasoning or laws aimed at protecting individual rights and justice. For example, R. Edward Freeman and Daniel Gilbert Jr. ask, "Must American managers in Saudi Arabia treat women as the Saudis treat them? Must American managers in South Africa treat blacks as white South Africans treat them? Must white South Africans treat blacks in the United States as U.S. managers treat them? Must Saudis in the United States treat women as U.S. managers treat them?"<sup>42</sup> They continue, "It makes sense to question whether the norms of the Nazi society were in

fact morally correct.”<sup>43</sup> Using rigorous ethical reasoning to solve moral dilemmas is important across cultures.

However, this does not suggest that flexibility, sensitivity, and awareness of individual and cultural moral differences are not necessary. It does mean that upholding principles of rights, justice, and freedom in some situations may conflict with the other person’s or culture’s belief system. Depending on the actions taken and decisions made based on a person’s moral standards, a price may be paid for maintaining them. Often, negotiation agreements and understanding can be reached without overt conflict when different ethical principles or cultural standards clash.

Finally, it could be argued that cultural relativism does provide an argument against cultural imperialism. Why should American laws, customs, and values that are embedded in a U.S. firm’s policies be enforced in another country that has differing laws and values regarding the activities in question?

Figure 3.4 summarizes the ethical principles presented here. This figure can be used as a reference for applying these principles individually and in a stakeholder analysis with groups.

## Ethical Relativism and Stakeholder Analysis

When considering the perspectives of relativism in a stakeholder analysis, ask the following questions:

1. What are the major moral beliefs and principles at issue for each stakeholder affected by this decision?
2. What are my moral beliefs and principles in this decision?
3. To what extent will my ethical principles clash if a particular course of action is taken? Why?

How can conflicting moral beliefs be avoided or resolved in seeking a desirable outcome?

What is the industry standard and norm with regard to this issue(s)?

An example of an ethical relativist is Sam Waksal, who resigned as CEO of ImClone (a manufacturer of drugs for cancer and other treatment therapies) on May 22, 2002. He was arrested for securities fraud and perjury and was indicted for bank fraud, securities fraud, and perjury. He pleaded guilty to all of the counts in the indictment. (He also implicated his daughter and father in his insider trading schemes.) In addition, he pleaded guilty to tax evasion for not paying New York state sales tax on pieces of art that he purchased. He was sentenced to 87 months in prison and was ordered to pay a \$3 million fine and \$1.2 million in restitution to the New York State Sales Tax Commission. He began serving his prison sentence on July 23, 2003. Martha Stewart, an ImClone stockholder, was sentenced to five months in prison and five months of house arrest for being involved in using insider trading knowledge to sell shares of ImClone stock. She was also ordered to pay \$30,000 in fines and court fees. Her broker, Peter Bacanovic, was given the same sentence, but a lower fine of \$4,000. Bacanovic’s assistant, Douglas Faneuil, was spared prison time and fined \$2,000.<sup>44</sup> When asked in an interview how he got into this “mess,” Waksal said: “It certainly wasn’t

because I thought about it carefully ahead of time. I think I was arrogant enough at the time to believe that I could cut corners, not care about details that were going on, and not think about consequences.”<sup>45</sup>

### 3.10 IMMORAL, AMORAL, AND MORAL MANAGEMENT

It is possible for owners, managers, and individual stakeholders to relate to their constituencies from three broad orientations: immorality, amorality, and morality.

*Immoral treatment* of constituencies signifies a minimally ethical or unethical approach, such as laying off employees without fair notice or compensation, offering upper-level management undeserved salary increases and perks, and giving “golden parachutes” (attractive payments or settlement contracts to selected employees) when a change in company control is negotiated. (Such payments are often made at the expense of shareholders’ dividends without their knowledge or consent.) Managing immorally means intentionally going against the ethical principles of justice and fair and equitable treatment of other stakeholders.

*Amoral management* happens when owners, supervisors, and managers treat shareholders, outside stakeholders, and employees without concern or care for the consequences of their actions. No willful wrong may be intended, but neither is thought given to moral behavior or outcomes. Minimal action is taken while setting policies that are solely profit-oriented, production-centered, or short term. Employees and other stakeholders are viewed as instruments for executing the economic interests of the firm. Strategies, control systems, leadership style, and interactions in such organizations also reflect an amoral, minimalist approach toward stakeholders. Nevertheless, the harmful consequences of amoral actions are real for the persons affected.

*Moral management* places value on fair treatment of shareholders, employees, customers, and other stakeholders. Ethics codes are established, communicated, and included in training; employee rights are built into visible policies that are enforced; and employees and other stakeholders are treated with respect and trust. The firm’s corporate strategy, control and incentive systems, leadership style, and interactions reflect a morally managed organization. Moral management is the preferred mode of acting toward stakeholders, since respect and fairness are considered in decisions.

It is helpful to consider these three orientations while observing managers, owners, employees, and coworkers. Have you seen amoral policies, procedures, and decisions in organizations? The next section summarizes four social responsibility roles (Figure 3.4) that business executives view as moral for decision makers. The model presented complements the five ethical principles by providing a broad framework for describing ethical orientations toward business decisions. You may want to use the following framework to characterize your own moral and responsible roles, those of your boss and colleagues, and even those of contemporary international figures in government or business.

3.11 FOUR SOCIAL RESPONSIBILITY ROLES

What social obligations do businesses and their executives have toward their stockholders and society? The traditional view that the responsibility of corporate owners and managers is to serve only, or primarily, their stockholders’ interests has been challenged and modified—but not abandoned—since the turn of this century. The debate continues about whether the roles of businesses and managers include serving social stakeholders along with economic stockholders. Because of changing demographic and educational characteristics of the workplace and the advent of laws, policies, and procedures that recognize greater awareness of employee and other stakeholders’ rights, distinctions have been made about the responsibility of the business to its employees and to the larger society.

Four ethical interpretations of the social roles and modes of decision making are discussed and illustrated in Figure 3.4 The four social responsibility modes reflect business roles toward stockholders and a wider audience of stakeholders.<sup>46</sup>

Figure 3.4 illustrates two distinct social responsibility orientations of businesses and managers toward society: the *stockholder model* (the primary responsibility of the corporation to its economic stockholders) and the *stakeholder model* (the responsibility of the corporation to its social stakeholders outside the corporation). The two sets of motives underlying these two orientations are “self-interest” and “moral duty.”

The stockholder self-interest (box 1 in Figure 3.4) and moral duty (box 3) orientations are discussed first, followed by the stakeholder self-interest (box 2) and moral duty (box 4) orientations. The two stockholder orientations are productivism and philanthropy.

*Productivists* (who hold a free-market ethic) view the corporation’s social responsibility in terms of rational self-interest and the direct fulfillment of stockholder interests. The free market values the basis of rewards and punishments in the organization. This ethic drives internal and external

Figure 3.4

Four Social Responsibility Modes and Roles

		ORIENTATIONS	
		Stockholder Model	Stakeholder Model
MOTIVES	Self-Interest	1 Productivism	2 Progressivism
	Moral Duty	3 Philanthropy	4 Ethical Idealism

**SOURCE:** Anthony F. Buono and Lawrence T. Nichols. 1990. Stockholders and stakeholder interpretations of business’ social rule. In *Business Ethics: Readings and Cases in Corporate Morality*, 2d ed., edited by Michael Hoffman and Jennifer Moore. New York: McGraw-Hill, 172. Reproduced with permission of Anthony F. Buono.

vision, mission, values, policies, and decisions—including salaries, promotion, and demotions. Productivists believe the major—and, some would say, only—mission of business is to obtain profit. The free market is the best guarantee of moral corporate conduct in this view. Supply-side economists as productivists, for example, argue that the private sector is the vehicle for social improvement. Tax reduction and economic incentives that boost private industry are policies that productivists advocate as socially responsible. President George W. Bush's response to the subprime lending crisis exemplifies a productivist approach; as BBC New reported, Bush's efforts include "reform tax laws to help troubled borrowers refinance their loans, but the President added that it was not the government's job to bail out speculators."<sup>47</sup>

Although all the ethical principles discussed earlier could be used by organizational leaders within each of these responsibility modes, productivists might advocate the use of *negative rights* to promote policies that protect shareholders' interests over positive rights that would cost taxpayers and use government resources to assist those more economically dependent on government services—who, productivists would argue, add an economic burden to the free market system.

A free-market-based ethic is widely used by owners and managers who must make tough workplace decisions, such as: (1) How many and which people are to be laid off because of a market downturn and significantly lower profits? (2) What constitutes fair notice and compensation to employees who are to be terminated from employment? (3) How can employees be disciplined fairly in situations in which people's rights have been violated? A company is entitled to private property rights and responsibilities to shareholders. Robert Nozick, a Libertarian philosopher, is an advocate of a market-based ethic. He makes his case for a market-based principle of justice and entitlement in his book *Anarchy, State, and Utopia* (New York: Basic Books, 1974). Opponents to the market-based ethic argue that the rights of less-advantaged people also count, that property rights are not absolute in all situations, that there are times when the state can be justified in protecting the rights of others in disputes against property owners, and that the distribution of justice depends on the conditions of a situation—if war, illegal entry, fraud, or theft occur, some form of redistribution of wealth can be justified.<sup>48</sup>

*Philanthropists*, who also have a stockholder view of the corporation, hold that social responsibility is justified in terms of a moral duty toward helping less-advantaged members of society through organized, tax-deductible charity and *stewardship*. Proponents of this view believe that the primary social role of the corporation is still to obtain profits. However, moral duty drives their motives instead of self-interest (the productivist view). Advocates of this view are stewards and believe that those who have wealth ought to share it with disadvantaged people. As stockholder stewards, philanthropists share profits primarily through their tax-deductible activities. Warren Buffett gave 85 percent of his wealth, estimated over \$44 billion, to philanthropic causes, including the Bill & Melinda Gates Foundation. The remainder will be given to foundations operated by his children.<sup>49</sup>

Philanthropists might argue from principles of utilitarianism, duty, and universalism to justify their giving. Corporate philanthropy, generally speaking, is based primarily on the profit motive. Corporate philanthropists' sense of stewardship is contingent on their available and calculated use of wealth to help the less economically advantaged.

*Progressivism* and *ethical idealism* are the two social responsibility modes in the stakeholder model, the other dominant orientation. *Progressivists* believe corporate behavior is motivated by self-interest, but they also hold that corporations should take a broader view of responsibility toward social change. Enlightened self-interest is a value that characterizes progressivists. Reinhold Niebuhr, the Christian theologian, was a modern example of a progressivist who argued for the involvement of the church in politics to bring about reasoned, orderly reform. He also worked with unions and other groups to improve workers' job conditions and wages. Progressivists support policies such as affirmative action, environmental protection, employee stock option programs (ESOPs), and energy conservation. Did ice cream maker Ben and Jerry's follow a progressivist philosophy for their formerly independent company?

Finally, *ethical idealists* believe that social responsibility is justified when corporate behavior directly supports stakeholder interests. Ethical idealists, such as Ralph Nader earlier in his career, hold that, to be fully responsible, corporate activity should help transform businesses into institutions where workers can realize their full potential. Employee ownership, cooperatives, and community-based and owned service industries are examples of the type of corporate transformation that ethical idealists advocate. The boundaries between business and society are fluid for ethical idealists. Corporate profits are to be shared for humanitarian purposes—to help bring about a more humane society.

Of course, as noted previously, a spectrum of beliefs exists for each of these four modes. For example, ethical idealists profess different visions regarding the obligations of business to society. Progressivists and ethical idealists generally tend to base their moral authority on legal and moral rights, justice, and universalism. Organizational leaders and professionals are obviously concerned with the operational solvency and even profitability (especially for-profit firms) of their companies. Still, they tend to believe that stakeholder interests and welfare are necessary parts of the economic system's effectiveness and success.

Which orientation best characterizes your current beliefs of business responsibility toward society: productivism, philanthropy, progressivism, or ethical idealism?

### 3.12 INDIVIDUAL ETHICAL DECISION-MAKING STYLES

In addition to the four social responsibility modes, researchers have defined ethical styles. Stanley Krolick developed a survey that interprets individual primary and secondary ethical decision-making styles.<sup>50</sup> The four styles he found are (1) individualism, (2) altruism, (3) pragmatism, and (4) idealism. These four styles are summarized here to complement the

social responsibility modes and the ethical principles we have discussed. Caution must be used when considering any of these schemes to avoid stereotyping. These categories are guides for further reflection, discussion, and study.

*Individualists* are driven by natural reason, personal survival, and preservation. The self is the source and justification of all actions and decisions. Individualists believe that “If I don’t take care of my own needs, I will never be able to address the concerns of others.”<sup>51</sup> The moral authority of individualists is their own reasoning process, based on self-interest. Individualism is related to the principle of naive ethical relativism and to productivism.

*Altruists* are concerned primarily with other people. Altruists relinquish their own personal security for the good of others. They would, as an extreme, like to ensure the future of the human race. The altruist’s moral authority and motivation is to produce the greatest good for the largest number of people. Unlike utilitarians, altruists would not diligently calculate and measure costs and benefits. Providing benefits is their major concern. Altruists justify their actions by upholding the integrity of the community. They enter relationships from a desire to contribute to the common good and to humankind. Altruists are akin to universalists and philanthropists.

*Pragmatists* are concerned primarily with the situation at hand, not with the self or the other. The pragmatist’s bases for moral authority and motivation are the perceived needs of the moment and the potential consequences of a decision in a specific context. The needs of the moment dictate the importance of self-interest, concern for others, rules, and values. Facts and situational information are justifications for the pragmatist’s actions. Pragmatists may abandon significant principles and values to produce certain results. They are closest philosophically to utilitarians. Although this style may seem the most objective and appealing, the shifting ethics of pragmatism make this orientation (and the person who espouses it) difficult and unpredictable in a business environment.

*Idealists* are driven by principles and rules. Reason, relationships, or the desired consequences of an action do not substitute for the idealist’s adherence to principles. Duties are absolute. Idealists’ moral authority and motivation are commitment to principles and consistency. Values and rules of conduct are the justification that idealists use to explain their actions. Seen as people with high moral standards, idealists can also be rigid and inflexible. Stanley Krolick states, “This absolute adherence to principles may blind the idealist to the potential consequences of a decision for oneself, others, or the situation.”<sup>52</sup> This style is related to the social responsibility mode of ethical idealism and to the principle of universalism.

Which of the four styles best characterizes your ethical orientation? The orientation of your colleagues? Your supervisor or boss?

## Communicating and Negotiating across Ethical Styles

When working or communicating with an ethical style, you also must observe *the other person’s ethical style*. According to Krolick, the first step is to “concede that the other person’s values and priorities have their own validity in their own terms and try to keep those values in mind to facilitate the



process of reaching an agreement.<sup>53</sup> The following guidelines can help when communicating, negotiating, or working with one of the four ethical styles:

- *Individualist*: Point out the benefits to the other person's self-interest.
- *Altruist*: Focus on the benefits for the various constituencies involved.
- *Pragmatist*: Emphasize the facts and potential consequences of an action.
- *Idealist*: Concentrate on the principles or duties at stake.

Learning to recognize and communicate with people who have other ethical styles and being flexible in accommodating their ethical styles, without sacrificing your own, are important skills for working effectively with others.

### 3.13 QUICK ETHICAL TESTS

In addition to knowing the ethical principles, social responsibility modes, and ethical styles presented in this chapter, businesspeople can take short "ethical tests" before making decisions. Many of these rules reflect the principles discussed in this chapter. These "checkpoints," if observed, could change the actions you would automatically take in ethical dilemmas.

The Center for Business Ethics at Bentley College articulated six simple questions for the "practical philosopher." Before making a decision or acting, ask the following:

1. Is it right?
2. Is it fair?
3. Who gets hurt?
4. Would you be comfortable if the details of your decision were reported on the front page of your local newspaper?
5. What would you tell your child to do?
6. How does it smell? (How does it feel?)

Other quick ethical tests, some of which are classic, include:

- *The Golden Rule*: "Do unto others as you would have them do unto you." This includes not knowingly doing harm to others.
- *The Intuition Ethic*: We know apart from reason what is right. We have a moral sense about what is right and wrong. We should follow our "gut feeling" about what is right.
- *The Means-Ends Ethic*: We may choose unscrupulous but efficient means to reach an end if the ends are really worthwhile and significant. Be sure the ends are not the means.
- *The Test of Common Sense*: "Does the action I am getting ready to take really make sense?" Think before acting.
- *The Test of One's Best Self*: "Is this action or decision I'm getting ready to take compatible with my concept of myself at my best?"
- *The Test of Ventilation*: Do not isolate yourself with your dilemma. Get others' feedback before acting or deciding.
- *The Test of the Purified Idea*: "Am I thinking this action or decision is right just because someone with authority or knowledge says it is right?" You may still be held responsible for taking the action.<sup>54</sup>



Use these principles and guidelines for examining the motivations of stakeholders' strategies, policies, and actions. Why do stakeholders act and talk as they do? What principles drive these actions?

### 3.14 CONCLUDING COMMENTS

Individual stakeholders have a wide range of ethical principles, orientations, and “quick tests” to draw on before solving an ethical dilemma. Using moral reflection and creativity is also important when deciding between two “right” or “wrong” choices. Reflecting on one’s core values combined with a sense of moral courage and shrewdness are also a recommended part of this decision-making process. When there are multiple stakeholders in a dilemma, the moral dimension of the stakeholder approach can be helpful by identifying the “ground rules” or “implicit morality” of institutional members. As R. Edward Freeman and Daniel Gilbert Jr. state:

Think of the implicit morality of an institution as the rules that must be followed if the institution is to be a good one. The rules are often implicit, because the explicit rules of an institution may be the reason that the institution functions badly. Another way to think of the implicit morality of an institution is as the internal logic of the institution. Once this internal logic is clearly understood, we can evaluate its required behaviors against external standards.<sup>55</sup>

### Back to Louise Simms...

Let’s return to the scenario in which Louise Simms is trying to decide what to do. Put yourself in Louise’s situation. Identify your ethical decision-making style. Are you primarily an idealist, pragmatist, altruist, or individualist? What are some of your blind spots? Consider the three questions regarding a “defining moment” at the beginning of the chapter: “Who am I?” “Who are we?” “Who is the company?” What courses of action are available after reviewing your responses to these questions? Then, describe the ethical principles you usually follow in your life: utilitarianism, rights, justice, universalism, ethical virtue, ethical relativism, the common good ethic. Describe Louise’s organization. Is it characterized as productivist (i.e., market ethics)? Progressive? Philanthropic? Idealist? What is your moral responsibility to yourself, your family and friends, your colleagues and work team, and to the company? Now make Louise’s decision and share your decision with your classmates and consider their responses. Do you think you made the right decision?

## CHAPTER SUMMARY

Complex ethical dilemmas in business situations involve making tough choices between conflicting interests. This chapter begins with questions for addressing dilemmas and “defining moments” creatively, boldly, and shrewdly. Twelve questions and three decision criteria that can assist individuals in determining the most suitable course of action are presented.

Individuals can gain a clear perspective of their own motivations and actions by distinguishing them from those of others. This perspective can be useful for guiding your own decision-making process. Understanding the criteria from this chapter can enable you to reason more critically when examining other stakeholders' ethical reasoning.

A primary goal of ethical reasoning is to help individuals act in morally responsible ways. Ignorance and bias are two conditions that cloud moral awareness. Five principles of ethical reasoning are presented to expose you to methods of ethical decision making. Each principle is discussed in terms of the utility and drawbacks characteristic of it. Guidelines for thinking through and applying each principle in a stakeholder analysis are provided. These principles are not mechanical recipes for selecting a course of action. They are filters or screens to use for clarifying dilemmas.

Three ethical orientations, moral, amoral, and immoral, can be used to evaluate ethics. Moral and immoral orientations are more discernible than amoral motives. Amoral orientations include lack of concern for others' interests and well-being. Although no intentional harm or motive may be observed, harmful consequences from ignorance or neglect reflect amoral styles of operating.

Four social responsibility roles or business modes are productivism and philanthropy (influenced by stockholder concerns) and progressivism and ethical idealism (driven by stockholder concerns but also influenced by external stakeholders).

Individuals also have ethical decision-making styles. Four different (but not exclusive) styles are individualism, altruism, pragmatism, and idealism. Another person's ethical decision-making style must be understood when engaging in communication and negotiation. These styles are a starting point for identifying predominant decision-making characteristics.

The final section offers quick "ethical tests" that can be used to provide insight into your decision-making process and actions.

## QUESTIONS

1. Do you believe ethical dilemmas can be prevented and solved morally without the use of principles? Explain. Offer an example from a dilemma you recently experienced or currently are experiencing. Characterize the logic you used in thinking through or having made a decision. Compare the logic you used to principles and quick tests in this chapter. What similarities and differences did you discover? Can you include any of the principles and ethical reasoning in this chapter in dilemmas you may or expect to face? Explain.
2. Why are creativity and moral imagination oftentimes necessary in preventing and resolving ethical dilemmas and "defining moments" of conflict in one's workplace? Offer an example of an ethically questionable situation in which you had to creatively improvise to "do the right thing."

3. What is a first step for addressing ethical dilemmas? What parts of this chapter would and could you use to complement or change your own decision-making methods?
4. Read one of the cases at the end of this chapter, then describe the type of reasoning the leaders or a major stakeholder in the case used in his/her/their decision(s). Now, refer to the three criteria that can be used in ethical reasoning in this chapter. If the individuals or groups you just studied in this case had used the three criteria of ethical reasoning in this chapter, what if any differences would you have expected to observe in the case results? Explain.
5. What single question is the most powerful for solving ethical dilemmas?
6. What are two conditions that eliminate a person's moral responsibility?
7. Return to the case you selected in question 4 above. Briefly explain which of the chapter's five fundamental principles of ethical reasoning the leaders and/or major stakeholders you identified used and did not use in the case. Which ethical principle(s) would you recommend that they should have used? Why?
8. What are some of the problems characteristic of cultural relativism? Offer an example in the news of a company that has acted unethically according to the perspective of cultural relativism.
9. Why is utilitarianism useful for conducting a stakeholder analysis? What are some of the problems with using this principle? Give an example of when you used utilitarianism to justify an ethically questionable action.
10. Briefly explain the categorical imperative. What does it force you, as a decision maker, to do when choosing an action in a moral dilemma?
11. Explain the difference between the principles of rights and justice. What are some of the strengths and weaknesses of each principle?
12. Which of the four social responsibility modes most accurately characterizes your college/university and place of work? Explain. Do your ethics and moral values agree with these organizations? Explain.
13. Briefly explain your ethical decision-making style as presented in the chapter.
14. Explain what ethical logic and actions people generally take to persuade you to do something that is ethically questionable. Refer to the ethical decision styles in the chapter.
15. Which of the ethical "quick tests" do you prefer? Why?

## EXERCISES

1. Describe a serious ethical dilemma you have experienced. Use the 12 questions developed by Laura Nash to offer a resolution to the problem, even if your resolution is different from the original experience. Did you initially use any of the questions? Would any of these questions have helped you? How? What would you have done differently? Why?

2. Identify an instance when you thought ignorance absolved a person or group from moral responsibility. Then identify an example of a person or group failing to become fully informed about a moral situation. Under what conditions do you think individuals are morally responsible for their actions? Why?
3. With which of the four social responsibility business modes in the chapter do you most identify? Why? Name a company that reflects this orientation. Would you want to work for this company? Would you want to be part of the management team? Explain.
4. Select a corporate leader in the news who acted legally but immorally and one who acted illegally but morally. Explain the differences of the actions and behaviors in each of the two examples. What lessons do you take from your examples?
5. Select two organizations in the same industry that you are familiar with or that are in the media or online news, such as McDonald's and Burger King, Toyota and General Motors, Virgin Airlines and American Airlines. Research some of the latest news items and activities about each company and its officers over the same time period. Now, using ethical principles and quick tests from this chapter, compare and contrast each. Evaluate how "ethical" each is compared to the other.

## REAL-TIME ETHICAL DILEMMA



I was employed as a certified public accountant (CPA) for a regional accounting firm that specialized in audits of financial institutions and had many local clients. My responsibilities included supervising staff, collecting evidence to support financial statement assertions, and compiling work papers for managers and partners to review. During the audit of a publicly traded bank, I discovered that senior bank executives were under investigation by the FDIC for removing funds from the bank. They were also believed to be using bank funds to pay corporate credit card bills for gas and spouses' expenses. The last allegation noted that the executives were issuing loans to relatives without proper collateral.

After reviewing the work papers, I found two checks made payable to one executive of the bank that were selected during a cash count from two tellers. There was no indication based on our sampling that expenses were being paid for spouses. My audit manager and the chief financial officer (CFO) of my firm were aware of these problems.

After the fieldwork for the audit was completed, I was called into the CEO's office. The CEO and the chief operating officer (COO) stated that the FDIC examiners wanted to interview the audit manager, two staff accountants, and me. The CEO then asked the following question: "If you were asked by the FDIC about a check or checks made payable to bank executives, how would you answer?" I told them that I would

answer the FDIC examiners by stating that, during our audit, we made copies of two checks made payable to an executive of the bank for \$8,000 each.

The COO stated that during his review of the audit work papers he had not found any copies of checks made payable to executives. He also stated that a better response to the question regarding the checks would be, "I was not aware of reviewing any checks specifically made payable to the executive in question." The COO then said that the examiners would be in the following day to speak with the audit staff. I was dismissed from the meeting.

Neither the CEO nor the COO asked me if the suggested "better" response was the response I would give, and I did not volunteer the information. During the interview, the FDIC investigators never asked me whether I knew about the checks. Should I have volunteered this information?

### Questions

1. What would you have done? Volunteered the information or stayed silent? Explain your decision.
2. Was anything unethical going on in this case? Explain.
3. Describe the "ethics" of the officers of the firm in this case.
4. What, if anything, should the officers have done, and why?
5. What lessons, if any, can you take from this case, as an employee working under company officials who have more power than you do?

## Case 6

### Samuel Waksal and ImClone

**Seeking Approval for Erbitux** For several years, ImClone, a biotechnology company, was a “darling” of Wall Street. Its stock price rose from less than \$1 per share in 1994 to \$72 a share in November 2001. “The whole time it was producing nothing for sale. It did generate some revenue through licensing agreements with other drug companies—signs that the pharmaceutical industry did think ImClone was on to something.” ImClone focused on developing a cancer treatment drug called Erbitux. Erbitux is intended to make cancer treatment more effective by “targeting a protein called epidermal growth factor receptor (EGFR), which exists on the surface of cancer cells and plays a role in their proliferation.”

In its 10-K Annual Report for the fiscal year ending December 31, 2001, ImClone described Erbitux as the company’s “lead product candidate” and indicated that Erbitux had been shown in early stage clinical trials to cause tumor reduction in certain cases. ImClone had planned to market the drug in the United States and Canada with its development partner, Bristol-Myers Squibb. On September 19, 2001, ImClone announced that Bristol-Myers Squibb had paid \$2 billion for the marketing rights to Erbitux and would co-develop and co-promote Erbitux with ImClone.

ImClone was one of at least five pharmaceutical companies with EGFR drugs in mid- to late-stage testing. The winners at commercialization of a new drug class—such as EGFR—are the “companies that beat their rivals to market, since doctors tend to embrace the initial entries.” Under this pressure, ImClone took a testing shortcut, using what is known as a single-armed study—one which is conducted without a control group. ImClone’s use of the

single-armed study failed to meet the United States Food and Drug Administration’s (FDA) rigorous criteria for using the methodology.

Samuel Waksal, ImClone’s co-founder and chief executive officer at the time, was directly involved in coordinating and publicizing ImClone’s efforts to develop Erbitux and to obtain FDA approval for it. On June 28, 2001, ImClone began the process of submitting a rolling application—called a Biologics License Application (BLA)—seeking FDA approval for Erbitux. On October 31, 2001, ImClone submitted to the FDA the final substantial portion of its BLA. The FDA had a 60-day period within which a decision had to be made concerning whether to accept the BLA for filing. The FDA had three options: (1) accept ImClone’s BLA for filing; (2) accept the BLA for filing, but simultaneously issue a disciplinary review letter notifying ImClone that the BLA still had serious deficiencies that would need to be corrected before the BLA could be approved; or (3) refuse to approve the drug by issuing a Refusal to File letter (RTF). When the FDA issues a RTF, the applicant must file a new BLA to start the process over.

#### Samuel Waksal’s Reaction to the Impending Refusal to File

On December 25, 2001, Bristol-Myers Squibb learned from a source at the FDA that the FDA would issue a RTF letter on December 28, 2001. On the evening of December 26, 2001, Waksal learned of the FDA’s decision and attempted to sell 79,797 shares of ImClone stock that were held in his brokerage account with Merrill Lynch. He initially told his agent to transfer the shares to his daughter’s account. The following morning he instructed his agent to sell the shares. When Waksal’s

agent called Merrill Lynch in order to sell the shares, the agent was told that the shares were restricted and could not be sold without the approval of ImClone's legal counsel. When Merrill Lynch refused to conduct the transaction, Waksal ordered his agent to transfer the shares to Bank of America and then sell them. Bank of America also refused to conduct the transaction, and the shares were never sold.

On December 26, 2001, Waksal contacted his father, Jack Waksal, informing him of the impending RTE. The next morning, Jack Waksal placed an order to sell 110,000 shares of ImClone stock. Jack Waksal also called Prudential Securities and placed an order to sell 1,336 shares of ImClone stock from the account of Patti Waksal. On December 28, Jack Waksal sold another 25,000 shares of ImClone stock. When questioned by the staff of the Securities and Exchange Commission (SEC), Jack Waksal provided false and misleading explanations for these trades.

Also on the morning of December 27, 2001, before the stock market opened, Samuel Waksal had a telephone conversation with his daughter Aliza. At that time, Waksal was Aliza's only means of support, and he had control of her bank and brokerage accounts. During their conversation, he directed her to sell all of her ImClone shares. Immediately after talking to her father, Aliza placed an order at 9 a.m. to sell 39,472 shares of ImClone stock. By selling her shares at that moment in time, she avoided \$630,295 in trading losses.

On December 28, 2001, Waksal purchased 210 ImClone put option contracts, buying them through an account at Discount Bank and Trust AG in Switzerland. He sold all 210 put option contracts on January 4, 2002, which resulted in a profit of \$130,130. Waksal also failed to file a statement disclosing a change of ownership of his ImClone securities as required by Section 16(a) of the Exchange Act and Rule 16a-3.

According to the SEC, Waksal violated several sections of the Securities

Act when he attempted to sell his own ImClone Stock, when he illegally tipped his father about the FDA decision, when he caused Aliza to sell her shares of ImClone stock, and when he purchased ImClone put option contracts.

### **The Outcome for Samuel Waksal and ImClone**

Waksal resigned as ImClone's CEO on May 21, 2002. On June 12, 2002, he was arrested for securities fraud and perjury, and then two months later he was indicted for bank fraud, securities fraud, and perjury. On October 15, 2002, Waksal pled guilty to all of the counts in the indictment except those counts based on allegations that he passed material, nonpublic information to his father, Jack Waksal. On March 3, 2003, he also pled guilty to tax evasion charges for failing to pay New York State sales tax on pieces of art he had purchased. On June 10, 2003, Waksal was sentenced to 87 months in prison and was ordered to pay a \$3 million fine and \$1.2 million in restitution to the New York State Sales Tax Commission. Waksal began serving his prison sentence on July 23, 2003.

Unlike Waksal, ImClone appears to have survived the scandal. Under the leadership of Daniel Lynch, ImClone's former chief financial officer and its current chief executive officer, the company has staged a remarkable turnaround. Most of ImClone's 440 employees stayed with the company and helped Lynch revive it. Lynch says the employees stayed for one overpowering reason—they believed in Erbitux. As for himself, Lynch asserted that "What motivated me to get up in the morning was knowing that if I could get this drug approved, it would improve the lives of patients with cancer." Based on a clinical trial by Merck KGaA, ImClone's European marketing partner, the FDA, on February 12, 2004, "approved Erbitux for treating patients with advanced colon cancer that has spread to other parts of the body." Thus, Erbitux became ImClone's first commercial product.

## Questions for Discussion

1. What might motivate an individual or a company to short-cut drug testing that is crucial for FDA approval?
2. Why did Samuel Waksal react as he did pursuant to learning that the FDA would not approve Erbitux?
3. Why were Samuel Waksal's actions unethical?

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## Case 7

### Aaron Feuerstein and Malden Mills: How Values Guided Actions in a Post-Crisis Situation

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**Malden Mills: A Burning Crisis** On the night of December 11, 1995, Aaron Feuerstein was celebrating his 70th birthday, but would soon face major challenges, both personally and professionally. Late that night, Feuerstein raced from the festivities and socializing to the site of a horrible inferno, where he saw three of four nineteenth-century factory buildings burn to the ground. The buildings housed Malden Mills, a textile business that had been in the Feuerstein family for three generations. Located in Lawrence, Massachusetts, the company was founded by Feuerstein's grandfather in 1906. The company's most notable product at the time of the fire was Polartec, an outerwear fabric manufactured from recycled plastic bottles. Companies like L.L. Bean, Patagonia, and Lands' End used Polartec in their winter clothing lines.

Michael Lavallee, one of many employees who rushed to the site, stood alongside Feuerstein, watching the buildings burn as 60-mile-per-hour winds fanned the flames. Lavallee lamented, "It's done. It's done. It's gone." Feuerstein saw it differently. "This is not the end," he declared.

The day after the fire, Feuerstein met with many of the company's 3,000 employees in the local high school gymnasium. "They thought they knew what he was going to say, that he was going to take millions of dollars in insurance payments, retire, and close what was left of the factory . . . or he was going to move his operation to Mexico or Asia." Feuerstein's employees were in for a major surprise. The employees listened in stunned silence as Feuerstein "told them that he had every intention of rebuilding his factory right there in Lawrence, and what's more, everyone would continue to receive full salary and benefits during construction." When he announced his intentions, almost all the

workers who were present cheered—and some of them wept.

The only building that did not burn to the ground was a warehouse that contained the Polartec finishing operation. The warehouse also stored new equipment awaiting installation. Malden Mills' employees set up the equipment in the warehouse and resumed production within 10 days. After a few weeks, output reached 230,000 yards per week, which was 100,000 more yards per week than before the fire. The increased production was attributed to the employees' creativity in doing their jobs and their commitment to Feuerstein. Not all employees were back at work immediately, but no one was laid off. Feuerstein kept all 3,000 employees on the payroll "for 90 days at a cost of \$1.5 million per week while the factories were being rebuilt."

Feuerstein received widespread acclaim for his decision to rebuild Malden Mills and his commitment to the company's employees and their communities. Some people viewed Feuerstein as a "saint." After all, didn't he act in the best interests of the employees and the community rather than in his own self-interest?

#### **Aaron Feuerstein: A Man of Values**

Feuerstein says that his decision to rebuild was simply about "doing the right thing." He believes that every decision has to be a good business decision as well as a good ethical decision. "We believe that when you make a business decision, it should not be based exclusively on how to make the bottom line look better so that the shareholders can have an immediate benefit," says Feuerstein. "It should be balanced. It should take into consideration what's right and wrong, as well as profit." Feuerstein maintains that "doing the right thing adds to the profitability of the corporation" in the long term.

Feuerstein displayed three sets of interrelated behaviors and associated attitudes in the aftermath of the 1995 fire that “may be judged as praiseworthy, post-crisis virtues.” These virtues are (a) leader sensitivity and responsiveness to the high levels of uncertainty faced by stakeholders, (b) deep-rooted feelings of support and value for employees, and (c) a commitment to rebuilding and renewal.

Feuerstein’s management philosophy, which is based on early experiences with his family and on his religious beliefs, includes being sensitive to people, assuming responsibility for all organization members, and fulfilling responsibilities to the community. When Feuerstein was growing up, he was frequently exposed to conversations between his father and grandfather about running Malden Mills. Business fairness, openness, loyalty, mutual trust, and cooperation were central to these conversations and to young Aaron’s development.

Feuerstein relies on the *Torah*, the book of Jewish law, for guidance in his managerial decisions and actions. Drawing on the *Torah*, Feuerstein, a practitioner of Orthodox Judaism, observes, “You are not permitted to oppress the working man, because he’s poor and he’s needy, amongst your brethren and amongst the non-Jew in your community.” Feuerstein often quotes a Jewish proverb that says, “When all is moral chaos, this is the time to be a ‘mensch.’” *Mensch* is a Yiddish word that describes a righteous man, a man with a heart. Known as the “Mensch of Malden Mills,” Feuerstein is perceived as a businessman who cares more about his workers than about his financial net worth.

**Feuerstein’s Critics** While acknowledging the widespread acclaim Feuerstein received for his post-crisis actions, some observers point out contradictions in his managerial and leadership behavior. Katarzyna Moreno, writing in *Forbes* magazine, cites investigations by the Occupational Safety and Health

Administration, the office of the Massachusetts state fire marshal, and Malden Mills’ insurance company that assert, “Malden repeatedly put its employees in harm’s way and should have known about unsafe working conditions—which may have contributed to the fire—but didn’t do enough to fix them and, instead, lobbied regulators to back off.”

Moreover, some of Feuerstein’s critics say his actions were those of a fool. “They think he should have pocketed the insurance proceeds, closed the business, and walked away. Or else they think he should have grabbed the chance to move the company to some state or country with lower labor costs.”

Thomas Teal, a writer for *Fortune* magazine, however, argued that Feuerstein is neither fool—nor saint. Rather, Teal maintains he is a businessman who “is as tough-minded as he is righteous.” In supporting this assertion, Teal notes that although Feuerstein believes in downsizing, he seeks “to keep growing fast enough to give new jobs to the people that technology displaces, to weed out unnecessary jobs ‘without crushing the spirit of the work force.’” Teal also cites Feuerstein’s belief that simply seeking lower-cost labor by moving the company out of Lawrence, Massachusetts, might compromise Malden Mills’ true competitive advantage—product quality.

**Pushed into Bankruptcy Protection** In the years after rebuilding the factory, Malden Mills fell upon some difficult times. For the fiscal year ending October 31, 2001, operating income, projected at the beginning of the year to be \$45 million, actually came in at \$1.5 million. This resulted from warm weather that produced a drastic drop in sales of Polartec and “a tide of fleece knockoffs that flooded the market.” Malden Mills became so mired in debt that it filed for Chapter 11 bankruptcy protection on November 29, 2001. At the time of the bankruptcy filing, the company’s annual interest on its debt was \$19 million, its liabilities totaled \$180 million, and its depreciated assets were valued at \$190 million.

As the 2001 fiscal year came to a close, Malden Mills' creditors brought in Frank Budetti and David Orlofsky, turnaround specialists from Kroll Zolfo Cooper Inc., to help run Malden Mills on a day-to-day basis. Feuerstein's role in running Malden Mills diminished significantly. GE Capital, Malden Mills' major creditor and its largest shareholder, along with other creditors, took control of the company following its bankruptcy filing.

When Malden Mills emerged from bankruptcy in the spring of 2003, Feuerstein retained his positions as president and chairman but only owned a minority stake—about 5%—in the company. Malden Mills' creditors held the majority interest. Feuerstein was granted the option of buying back the company for \$157 million within the following three years, or for \$92 million if the cash could be raised by July 31, 2003. Feuerstein obtained commitments for a significant portion of the \$92 million repurchase price; some accounts indicate he raised all but about \$10 million. The federal bankruptcy court extended the deadline to August 21, but Feuerstein missed it.

In June 2004, Feuerstein relinquished his positions as president and chairman of Malden Mills. On July 26, 2004, the major creditors appointed Michael Spillane as president and chief executive officer. In late October 2004, Feuerstein made another bid to buy back Malden Mills; the company's board of directors rejected the bid. James Harde, spokesman for Malden Mills' creditor-installed management team, observed, "Feuerstein is guaranteed the right to buy back control of the company if he can come up with \$125 million—an amount that has risen over time." He added, "Mr. Feuerstein's offer was nowhere near the contractual option price. If he were to make an offer at the option price, then the company would accept it." As 2005 began, Feuerstein was still seeking to put together a repurchase deal.

In reaction to the board's rejection of the repurchase bid, Aaron's son, Daniel Feuerstein, emphasized his father's commitment to keeping manufacturing jobs in the United States rather than

offshoring them, as he suspects will be done if the Feuerstein family does not regain control of Malden Mills. Regarding his father, Daniel Feuerstein says, "He doesn't make false claims about community responsibility in one sentence and then surreptitiously offshore the jobs to the Pacific rim."

### **A Retrospective Look by a Man of Values**

In reflecting on the rebuilding decision, Feuerstein asserted that if he had to do it over, he would still make the same decision. He observed that Malden Mills' problems were "not a direct result of having acted fairly with workers and having treated them with respect." Rather, the problems resulted from a lack of adequate insurance to rebuild the factory with state-of-the-art equipment that would have enabled the company to continue producing the best quality in the marketplace. To cover the insurance shortage, Malden Mills borrowed heavily. Feuerstein commented, "Had I replaced the factory exactly as it was before the fire, I would have had enough insurance. But I wanted everything to be the absolute latest and best. As a result, we spent millions over what we were insured for." Feuerstein says, "I was proud of the family business and I wanted to keep that alive, and I wanted that to survive. But I also felt the responsibility for all my employees, to take care of them, to give them jobs." In pondering his own mortality, Feuerstein says that he wants to be remembered for not giving up and for trying to do the right thing.

### **Questions for Discussion**

1. Evaluate Aaron Feuerstein's decision to rebuild Malden Mills after the fire and to keep all employees on the payroll in terms of being a good business decision as well as an ethical decision. Explain your answer.
2. Describe Feuerstein as a "man of values."
3. What guidance can Feuerstein's values provide for your future behavior?

4. What challenges does seeking bankruptcy protection provide for a business owner who seems to care more about his workers than about his financial net worth?

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## Case 8

### Jerome Kerviel: Rogue Trader or Misguided Employee

What Really Happened at the French Bank, Société Générale?

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#### **Société Générale: A French Bank Globally Recognized**

The French banking company Société Générale (“SocGen” or “the Company”) was founded on May 4, 1864, and at the time of this writing is headed by co-CEOs Philippe Citerne and Daniel Bouton. The bank has grown to serve 19.2 million individual customers in 76 countries. It employs 103,000 workers from 114 different nationalities. SocGen operates in three major businesses: retail banking and financial services, global investment management and services, and corporate and investment banking. The core values at the Company are professionalism, team spirit, and innovation.

In 2006, SocGen ranked 67 on *Fortune’s* 2006 Global 500. Société Générale managed to build a \$72 billion position in European stock index futures. The year before, the Company ranked 152 on *Fortune’s* list. In addition to top-line growth, SocGen also posted a more important improvement in overall profitability, at \$5.5 billion, up 42% from the prior year. It was the 14th largest company among the banking institutions on the list.

**The Beginning of the Story** Things were about to change for SocGen. Recent turmoil in 2006 revolved around the collapsing housing market and a mortgage industry that witnessed loan defaults in record numbers. Several banks engaged in purchasing high-risk mortgage loans, but the overall economic recession, primarily in the United States but also felt globally, constrained this bank’s financial status. SocGen saw its stock price cut almost in half throughout the year, but this was not the only potential pitfall for this once robust Company. It was the actions of one rogue trader, Jerome Kerviel, that could have signaled the ultimate downfall of SocGen.

#### **Who Is Jerome Kerviel and What Happened at the Bank?**

On January 24, 2008, Jerome Kerviel found himself in the international media spotlight, but not as he would have hoped. On this day, SocGen announced to the world that it had discovered a \$7.14 billion trading fraud caused by a single trader, Kerviel. Additionally, a nearly \$3 billion loss was posted due to the loss in investments in the U.S. subprime mortgage industry. The second largest bank in France had it shares halted to avoid a complete market collapse on the price of the stock.

From his modest roots to the upscale Paris suburb where he resided, friends and family never expected that this unmarried, 31-year-old could be capable of such a scandal. With a modest salary, \$145,700, Kerviel did not profit from his trading scheme. He had been an employee at SocGen since 2000. He began in a monitoring support role, and oversaw the futures traders for five years. He was then promoted to the futures trading desk. He traded European futures by betting on the future performance of these funds. Kerviel saw his trading profits increase throughout 2007 as he bet that the markets would fall during this time. By the end of the year he needed to mask his significant gains, so he created fictional losing positions to erode his gains. These included the purchasing of 140,000 DAX futures (the German stock index: a Blue Chip stock market index that includes the 30 major German companies trading on the Frankfurt Stock Exchange). By mid-January, Kerviel had lost over \$3 billion. He was hedging more than \$73.3 billion, an amount far in excess of the trading limits created by SocGen for a single trader. This amount even exceeded SocGen’s overall market cap of \$52.6 billion.

Despite five levels of increased security to prevent traders from assuming positions greater than a predetermined amount, and a group compliance division in charge of monitoring trader activity, Kerviel was able to bypass internal controls for over two years.

Kerviel's motive was not to steal from the bank, but to have his significant trading gains catapult his career, and to cash in on a significant bonus given to traders who exhibit the type of profitability he created for the Company. Red flags were triggered, but e-mails to his superiors on his trading activity were ignored due to his overall profitability for the Company. Kerviel admitted his wrongdoing, but stated that SocGen was partially responsible for not monitoring his activities correctly and by having rewarded his behavior with a proposed bonus of \$440,000. Kerviel stated that his actions were similar to those of other traders; he was just being labeled as the scapegoat in this investigation.

**Company Reaction** Once the fraud was detected in mid-January, 2008, SocGen immediately reported it to France's central bank, Bank of France. Over the next three trading days, SocGen employees began to unload all of Kerviel's positions into the marketplace. The Company attempted to complete this significant sale of securities in a manner that would not disrupt the normal market movement. The ripple effect of this action may have created additional pressure on the already falling world markets. Some analysts speculated that this action may even have influenced the U.S. Federal Reserve rate cut. SocGen management denied that action after it discovered that the trading fraud had a meaningful impact on the world marketplace. CEO Bouton stated that the three-day sell-off was in accordance with guidelines, and that the liquidation of a position at any one time could not be more than 10% of the given market.

After Kerviel admitted his guilt, his employment was terminated along with that of his supervisors. CEO David

Bouton submitted a formal resignation, along with second-in-command Phillipe Citerne; however, both were rejected by the Board of Directors. Employees at the Company staged demonstrations where they showed their support for Bouton.

The bank has stated that since the activity was brought to light, there has been a tightening on the internal controls, so that actions such as Kerviel's are no longer possible for a trader. On January 25, 2008, SocGen took out a full-page newspaper article apologizing to its customers for the scandal. On January 30, the board announced the formation of an independent committee to investigate the current monitoring practices and determine what measures can be put in place to prevent it from happening again. The committee would enlist the services of the auditing company PricewaterhouseCoopers. The Company also announced that it needs an influx of capital to stay afloat, and began looking to outside help to raise \$8.02 billion in new capital.

**Government Reaction** On January 26, 2008, Kerviel was taken into police custody for questioning regarding his trading activity at SocGen. Three complaints were issued to police, one by SocGen and two others by small shareholders.

This event was the focus at the World Economic Forum in Davos, Switzerland, which brought to light questions on how risk is managed within organizations. French Finance Minister Christine Lagarde was assigned the task of investigating the events and compiling a report on the failure of internal controls at SocGen. The report was then publicized in an effort to prevent similar fraudulent trading events from occurring in the future. A timeline of the events leading up to the trading losses was created in an effort to better understand the events that transpired. In the report, Lagarde stated that there should be an increase in penalties for banks that violate the commission's set rules. The president of France, Nicolas Sarkozy, stated that the events at

SocGen did not affect the “solidity and reliability of France’s financial system.” He wanted the Board of Directors to take action against senior management, including Bouton.

On January 28, 2008, Kerviel was charged with unauthorized computer activity and breach of trust. Plans to charge Kerviel with fraud and misrepresentation were also announced, which could carry a maximum prison time of seven years with fines of \$1.1 million. At the time of this writing, the fraud charge had not been accepted by the courts; however, prosecutors were seeking to appeal this to a higher court.

The government sought to prevent a hostile takeover of SocGen during this period. However, the European Union was in disagreement with the French government and stated that all bidders should be treated equally: “The same rules apply as in other takeover situations under free movement of capital rules. Potential bidders are to be treated in an indiscriminatory manner.” The current standout for a potential suitor is the largest bank in France, BNP Paribas. Many competitors are contemplating making an offer for the distressed Company—to purchase a portion or all of the bank’s assets.

**Why It Happened** Kerviel was able to evade detection because of his experience monitoring the traders in his early years at SocGen. Falsifying bank records and computer fraud were part of the intricate scheme that Kerviel created. Kerviel knew when he would be monitored by the bank and avoided any activity during those periods. He created a fictitious company and falsified trading records to keep his activity under wraps. Kerviel also used other employees’ computer access codes and falsified trading documents.

**Related Companies with Similar Troubles** In 1995, Barings, a British bank that had been in existence for more than 230 years, collapsed as the results of the actions of one futures

trader, Nick Leeson. Leeson lost more than \$1.38 billion when trading futures in the Asian markets.

In 1991, London-based Bank of Credit and Commerce International (BCCI) went bankrupt as the result of illegal trading activity and insider trading, losing over \$10 billion.

During the late 1980’s and early 1990’s, Yasuo Hamanako, a Japanese copper futures trader, cost his employer, Sumitomo Copper, \$2.6 billion.

## Is There More to the Story?

SocGen’s Board of Director member Robert Day sold \$126.1 million in shares on January 9, 2008, two weeks before the trading fraud was disclosed. He also sold \$14.1 million the next day for two charitable trusts he chaired. Trading also occurred on January 18. The total trading activity amounted to \$206 million. It was reported that Day did trade during the timeframe where it was acceptable for a board member to trade shares of stock. Accusations of insider trading have been denied.

The *Financial Times* in London has reported that SocGen may have known about the trading activities back in November, when the Eurex derivatives exchange questioned Kerviel’s trading positions and alerted the Company. This then calls into question the lack of oversight by the Company, and what responsibility SocGen has to its shareholders for this oversight. Kerviel accuses his supervisors of turning a blind eye to his activities because he was earning the Company a significant amount of money. He states that his profits should have raised concerns because they far exceeded the parameters of the transactions he was allowed to engage in.

## Part Two: Corporate Controls at SocGen

It has been stated that there were not enough safeguards in place to protect the bank from Kerviel’s activities. The following describes in detail the existing safeguards and focuses on the public ethical programs that SocGen has in place.



At SocGen, the Board of Directors and three corporate governance committees that were established in 1995 are in charge of creating and policing the Company through its internal rules and regulations. The Company engages in risk management by constantly reviewing its risk exposure in the variety of areas in which it operates. Due to the sensitivity of many of its banking projects, corporate governance remains at the forefront of the bank's activities. The three committees include the audit committee (in charge of review of the Company's draft financial statements prior to submission to the Board of Directors), the compensation committee (in charge of determining executive compensation packages), and the nomination committee (appoints new board members and executive officers).

The Board of Directors is responsible for the Company's overall strategy and the adherence to its defined set of internal rules. The risk assessment divisions operate autonomously from the other operating units. Reporting directly to general management, this group consists of 2000 employees who constantly monitor the activities of the other business units making sure they are in compliance with the internal rules established by the Board of Directors. Monthly meetings are held to review strategic initiatives and all new products must first receive the approval of the risk team before implementation may take place.

Internal audit groups have been put in place with the following assignments:

- Detect, measure, and manage the risks incurred;
- Guarantee the reliability, integrity and availability of financial and management data;
- Verify the quality of the information and communications systems.

All staff members are under constant day-to-day supervision to ensure their compliance with the regulations in place.

The Compliance Department was established in 1997 and is currently

responsible for monitoring all banking activities so that the actions of all employees are in the best interest of the Company. A charter is in place that extends beyond local law and attempts to cover the high ethical standards set by the Company. Three key principles of the group are to work only with well-known customers, always assess the economic legitimacy of the action, and have the ability to justify any stance taken.

The trading room had eight compliance staff members in 2006, with the goal of increasing this number in 2007. Anti-money laundering practices have also been in the spotlight during the last few years. In all, the group has increased overall training for 2006 to 50,000 hours, up from 24,000 in 2005. The total number of employees trained is 18,000 individuals.

The role of information technology has also increased in order to support the corporate governance initiative. GILT (Group Insider List Tool) monitors potential conflicts of interest and insider trading activity within the Company, and MUST (Monitoring of Unusual and Suspicious Transactions) is used to detect insider trading and market manipulation. The Company also has standards in place to prevent corruption on the part of Company employees and government officials.

A Code of Conduct has been in place since March 2005, with the goal of being a reference tool for employees that highlights the principles that the Company wants its employees to uphold. The Code was created as the result of the changes in the current business environment, since employees and society alike have set a higher standard for an individual Company's corporate responsibilities. Like many other companies that have a Code of Conduct, SocGen felt that establishing this Code was an essential part of operating in the current business environment.

The Chinese have established strict controls in an effort to prevent internal private information and confidential customer data from leaking to the outside



marketplace. Separation is a key component in this, whereby an effort is made to eliminate the chance of conflicts of interest on sensitive projects. There is restricted access to IT programs, and any potential conflict of interest must first be approved and signed off by the Compliance Department.

Compliance structures were put in place beginning in March 2005 as a result of a change in law by the French Banking and Financial Regulation Committee (Regulation No. 97–02). The secretary general of SocGen heads the Group Compliance Committee. Through monthly meetings, members of the group identify any potential risks on the part of the Company, develop ways to prevent future risks in new products, and engage in employee training in an effort to strengthen the idea of corporate compliance within the company culture.

### **Stakeholders and Their Roles**

The main stakeholder in this case is Jerome Kerviel. His actions were the primary driver behind the significant losses incurred by SocGen. However, although Kerviel may have been the focal stakeholder, there are several other primary stakeholders. Kerviel's direct supervisors were responsible for managing his actions. Senior management and the Board of Directors were responsible for implementing and enforcing guidelines. Employees of the Company are stakeholders since other traders' actions may have influenced Kerviel's decisions. SocGen employees are also stakeholders because the Kerviel case may have jeopardized their own careers within the Company. The final primary stakeholder is the shareholder who was negatively impacted by the huge trading losses at SocGen brought about by Kerviel.

Secondary stakeholders include the government, who is pushing the Board of Directors for Bouton's resignation, and the court systems that are prosecuting Kerviel and other individuals indicted on counts of insider trading. There are competitors, including BNP

Paribas, who may try to take advantage of this opportunity to purchase a portion of SocGen's operations at a devalued price. Finally, there is the public at large, whose confidence was yet again shaken by another scandal within a financial institution.

Potential coalitions involved in the events leading up to the trading scandal include traders and their managers, who may have ignored rules and regulations enacted by the governing committee at SocGen. Current coalitions may include shareholders who want to be reimbursed for the management oversight. Shareholder suits may also be brought against those identified as potentially engaging in insider trading. Finally, competition may be forming a coalition to section off the different business units of SocGen to complete a proposed buyout offer.

From the CEO's perspective, Kerviel might be seen as directly violating the rules put in place by the governing committee. Kerviel's managers also did not fully adhere to the established policies. The Board of Directors and the CEO are instrumental in the creation of the guidelines. The Board rejected Bouton's letter of resignation and many employees have been very supportive of him, stating that he was the person who could guide the Company through this trying time.

Each stakeholder in this case had varying degrees of power. Kerviel had the power to operate with limited supervision (although this was due to his manipulation of the system) and to have a significant impact on the overall bottom line at SocGen. The supervisors of the traders had a degree of power only over the traders, provided they were not blindsided by the traders' fraudulent activities. The Board of Directors was responsible for providing strategic guidance for the Company, electing a CEO, and establishing rules and regulations for the Company and its employees. The shareholders of SocGen stock had the power to vote on issues, since they are each individual owners of the Company. The government had the

power to influence how companies conducted business. The competitors impact the strategies a Company must undertake in order to stay ahead of its competition.

### Three Primary Stakeholders and their Obligations

Kerviel had a legal obligation not to engage in fraudulent behavior; this is evidenced by the fact that he was indicted in the French court system. His economic incentive was to make the most money possible for SocGen while minimizing risk. He was successful for two years, but as he failed to minimize overall risk, his behavior eventually caught up with him. He had an ethical responsibility to the management and his colleagues. He could be viewed as both a threat to the Company and a cooperative influence, depending on how management controlled the situation.

Kerviel's supervisors did not have as significant a legal obligation as Kerviel with regard to his specific responsibilities and actions. However, if they had been aware of his actions and did not act, then they can be seen as enabling him to commit illegal acts. They had an economic incentive to uphold the standards that senior management has put in place, since that is part of their job responsibility. Ethically, they had a responsibility to senior management, their colleagues, and their direct reports. It was the responsibility of senior management to work with the supervisors, and it was up to senior management to work with the supervisors to see that rules and regulations were upheld.

The Board of Directors has an obligation to make sure that the employees of the Company act in accordance with the laws of the country they reside in. The Board has an economic responsibility to the shareholders of stock in the Company. Ethically, the Board must create rules of conduct and ethical standards and practice a rule by example. The Board is a supportive, low-potential threat stakeholder that will probably cooperate with the CEO in this case.

### Questions for Discussion

1. Is Kerviel the only one who is guilty in this case with regard to his actions? Explain.
2. Should other individuals and the bank be held legally responsible and liable for Kerviel's actions? Why or why not? Explain.
3. Describe what you believe to have been Kerviel's personal and professional ethics. Use the terms from Chapter 3 as well as your own reasoning.
4. Compare your personal and professional ethic to Kerviel's.
5. Explain how a stakeholder and issues analysis methods can help you understand this case.
6. What are the lessons students in accounting, business, and organizational studies fields can take away from this case?

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## Case 9

### Seeking Two Kinds of Green: Richard Branson's Venture into Biofuels

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"Where others see disaster, Richard Branson sees opportunity. The founder of Virgin Group has business interests on six continents, including airlines, express trains, and limousine services, so his company's contribution to global warming worries him. But instead of wringing his hands, Branson sees a new fortune to be made in reinventing the fuel business, much the way he's made over air travel, credit cards, health care, and more. He's investing in conventional ideas like ethanol plants and solar power, but he's also developing a formula for a new ultraclean fuel that can power his jets as well as cars and trucks."

Branson used to be skeptical that global warming posed significant problems for the planet, so why the sudden interest in greenery? Branson says that "he has belatedly woken up to the dangers of global warming and is concerned the climate is near a 'tipping point' where small increases in greenhouse gases can lead to big changes in temperatures." His change of heart and belief came during a 2006 meeting with Al Gore, the former American vice-president who received a Nobel Prize for his advocacy on behalf of global warming. Al Gore's visit stimulated Branson to think about the threats that global warming posed for the planet and humanity. In contemplating the implications of global warming, Branson admits to reading a lot of books, including James Lovelock's *Gaia* and Tim Flannery's *The Weather Makers*, and meeting with other people who were passionate about effectively confronting global warming issues. Branson says, "In the end, I realized the world has a serious problem, and if we carry on putting too much carbon and methane into the earth's atmosphere, we're going to snuff out the people and all the world's species." After this enlightening experience, Branson says, "Now

I'm absolutely convinced that the world is spiraling out of control. CO<sub>2</sub> is like a bushfire that gets bigger and bigger every year. All of us who are in a position to do something about it must do something about it. Because Virgin is involved with planes and trains, we have even more responsibility. So we've put aside quite a lot of money to invest in alternative fuels. Over the next four years, we'll invest something like \$1 billion in alternative fuels."

Then in September 2006, at Bill Clinton's annual Global Initiative meeting in New York City, Branson announced an even greater commitment to addressing global warming problems. He announced that over the next 10 years he would dedicate all profits from his transportation businesses to developing renewable, sustainable alternatives to carbon fuels. The pledge, estimated at \$3 billion, is the largest monetary commitment yet made in the fight against global warming. In announcing the pledge, Branson stated, "We have to limit our dependence on fossil fuels. We hope that this contribution will help in some small way to enable our children to enjoy this beautiful world." Branson also said, "The idea is to try to take it out of the transportation businesses to send a message out, that if you are in the coal or airline or car business, it is important that we balance our [environmental] books." Branson has pledged that if Virgin's transportation businesses fail to generate enough profit to satisfy the \$3 billion commitment, he would likely fund any shortfall with profits from his cell phone, health club, or other businesses.

In February 2007 Branson went even further with his growing commitment to addressing the challenges of global warming. He announced the Virgin Earth Challenge, a prize of "\$25 million to anyone who helps impede climate change without seriously disrupting our way of life."

## **Biofuels and Virgin Airways: An Experiment in Environmental Green or Monetary Greed?**

Although aviation contributes less than 3% of all greenhouse gas emissions, “scientists have concerns that pollutants dropped directly into high altitudes may be more dangerous than those released on the ground.” This, in conjunction with an increasing number of governments worldwide that are imposing environmental taxes on airlines, makes the search for cleaner-burning jet fuels important for aviation. In response, Branson initiated a new business venture in mid-2006 to build ethanol plants and develop a new green product called Virgin Fuel. According to Branson, Virgin Fuel would be an alternative to corn-based ethanol and “could prove to work in cars within a year and even commercial jet engines within five years.” Virgin Fuel (cellulosic ethanol) would be derived “from cheap and abundant sources like prairie grass, agricultural waste, and the rubbish you chuck out from your home. It’s essentially emissions-free.”

In mid-January 2008, Richard Branson’s Virgin Atlantic Airways Ltd. announced that it would fly one of its Boeing 747s from London Heathrow to Amsterdam in February 2008—10 months earlier than planned—using a “blended mix of biofuel and kerosene, with at least 25% coming from the alternative fuel.” Then on Sunday, February 24, 2008, Virgin Atlantic flew the test flight from London to Amsterdam “with one of the four engines burning a mixture of 80% jet fuel and 20% oil from naturally grown plants.” Biofuel does not burn cleaner than kerosene-based jet fuel but biofuel proponents maintain that producing it is less harmful to the environment.

The Virgin Airways test was conducted in collaboration with Boeing, the aircraft’s manufacturer; General Electric, the maker of the aircraft’s engines; and Imperium Renewables of Seattle, the producer of the biofuel mixture. Both Boeing and GE asserted that the biofuel being tested did not necessitate any modification in jet

engines, which is “crucial to airline adoption since financially ailing airlines are unlikely to make major voluntary investments just to reduce emissions.” Imperium maintains that, with its technology, jet biofuel could be produced from almost any renewable crop. Interestingly, the substance that might hold the most promise for jet biofuel is algae—or pond scum. “Sewage-treatment plants offer an ample source, and algae-produced fuel would not use up food crops like corn, soybeans or even coconuts.”

## **Which Kind of Green Do Biofuels Represent?**

The utility of biofuels made from crops like corn has been questioned because of the impact on global food prices, damage to farmland, and the pollution that is created in producing the crops. Two environmental lobbying groups, Greenpeace and Friends of the Earth, have warned that biofuels may be less eco-friendly than they seem. In January 2008, the Royal Society, Britain’s national science academy, published a report which concluded that some biofuels may cause more climate change than gasoline—due to carbon emissions from fertilizers and processing. In short, the report asserts that if governmental “targets encourage people to use the wrong sort of fuel, transport may get dirtier, not cleaner.”

Moreover, “on a warming planet, land is an incredibly precious commodity, and every acre used to generate fuel is an acre that can’t be used to generate the food needed to feed us or the carbon storage needed to save us.” Biofuels can be highly beneficial if they don’t use arable agricultural land, and as long as fuel crops, such as switchgrass, are grown on degraded lands that cannot support food crops or cattle.

Branson maintains that Virgin Fuel is completely sustainable, both environmentally and socially, and that it does not compete with food and fresh water resources. He underscores the likelihood that, in the future, aviation biofuel would most likely be produced from algae. Even though Virgin Fuel is intended

to be environmentally and socially friendly, Branson emphasizes that the alternative fuels venture is also about business profitability and success. He emphatically says, "It's not just that we thought we should do this to try to save the world and the thousands of species that could die if we don't do it. Unless you can generate cash, it's not going to be successful. With oil prices above \$70 a barrel, people want to save on the cost of fuel, and so alternative fuels suddenly make business sense." Cynics point out that his hankering for greener planes and fuels might be aimed at reaping government subsidies for bio-fuels and heading off further regulation of transport emissions.

### Questions for Discussion

1. Do you believe that the production of biofuels is a viable solution for addressing both the world's energy needs and global warming? Why or why not?
2. Does Richard Branson's approach to tackling global warming issues provide a model that should be emulated? Explain your answer.
3. Clearly, Richard Branson believes that addressing global warming can also be a profitable business venture. In your opinion, must business profitability and success be coupled with solutions to global warming, or can global warming be solved without the constraints imposed by business profitability?

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## Case 10

### Ford's Pinto Fires: The Retrospective View of Ford's Field Recall Coordinator

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#### **Brief Overview of the Ford Pinto Fires**

Ford Motor Company, determined to compete with fuel-efficient Volkswagen and Japanese imports, introduced the subcompact Pinto in the 1971 model year. Lee Iacocca, Ford's president at the time, insisted that the Pinto weigh no more than 2,000 pounds and cost no more than \$2,000. Even with these restrictions, the Pinto met federal safety standards, although some people have argued that strict adherence to the restrictions led Ford engineers to compromise safety. Some two million units were sold during the 10-year life of the Pinto.

The Pinto's major design flaw—a fuel tank prone to rupturing with moderate-speed rear-end collisions—surfaced not too long after the Pinto's entrance to the market. In April 1974, the Center for Auto Safety petitioned the National Highway Traffic Safety Administration (NHTSA) to recall Ford Pintos due to the fuel tank design defect. The Center for Auto Safety's petition was based on reports from attorneys of three deaths and four serious injuries in moderate-speed rear-end collisions involving Pintos. The NHTSA did not act on this petition until 1977.

As a result of tests performed for the NHTSA, as well as the extraordinary amount of publicity generated by the problem, Ford Motor Company agreed, on June 9, 1978, to recall 1.5 million 1971–1976 Ford Pintos and 30,000 1975–1976 Mercury Bobcat sedan and hatchback models for modifications to the fuel tank. Recall notices were mailed to the affected Pinto and Bobcat owners in September 1978. Repair parts were to be delivered to all dealers by September 15, 1978.

Unfortunately, the recall was initiated too late for six people. Between June 9, 1978 and September 15, 1978, six people died in Pinto fires after a rear impact.

Three of these people were teenage girls killed in Indiana in August 1978 when their 1973 Pinto burst into flames after being rear-ended by a van. The fiery deaths of the Indiana teenagers led to criminal prosecution of the Ford Motor Company on charges of reckless homicide, marking the first time that an American corporation was prosecuted on criminal charges. In the trial, which commenced on January 15, 1980, "Indiana state prosecutors alleged that Ford knew Pinto gasoline tanks were prone to catch fire during rear-end collisions but failed to warn the public or fix the problem out of concern for profits." On March 13, 1980, a jury found Ford innocent of the charges. Production of the Pinto was discontinued in the fall of 1980.

#### **Enter Ford's Field Recall Coordinator**

Dennis A. Gioia, currently a professor in the Department of Management and Organization at Pennsylvania State University, was the field recall coordinator at Ford Motor Company as the Pinto fuel tank defect began unfolding. Gioia's responsibilities included the operational coordination of all the current recall campaigns, tracking incoming information to identify developing problems, and reviewing field reports of alleged component failures that led to accidents. Gioia left Ford in 1975. Subsequently, "reports of Pinto fires escalated, attracting increasing media attention." The remainder of this case, written in Gioia's own words in the early 1990s, is his personal reflection on lessons learned from his experiences involving the Pinto fuel tank problem.

#### **Why Revisit Decisions from the Early 1970s?**

I take this case very personally, even though my name seldom comes up in its many recountings.



I was one of those “faceless bureaucrats” who is often portrayed as making decisions without accountability and then walking away from them—even decisions with life-and-death implications. That characterization is, of course, far too stark and superficial. I certainly don’t consider myself faceless, and I have always chafed at the label of bureaucrat as applied to me, even though I have found myself unfairly applying it to others. Furthermore, I have been unable to walk away from my decisions in this case. They have a tendency to haunt—especially when they have had such public airings as those involved in the Pinto fires debacle have had.

But why revisit 20-year-old decisions, and why take them so personally? Here’s why: because I was in a position to do something about a serious problem . . . and didn’t. That simple observation gives me pause for personal reflection and also makes me think about the many difficulties people face in trying to be ethical decision makers in organizations. It also helps me to keep in mind the features of modern business and organizational life that would influence someone like me (me of all people, who purposely set out to be an ethical decision maker!) to overlook basic moral issues in arriving at decisions that, when viewed retrospectively, look absurdly easy to make. But they are not easy to make, and that is perhaps the most important lesson of all.

**The Personal Aspect** I would like to reflect on my own experience mainly to emphasize the personal dimensions involved in ethical decision making. Although I recognize that there are strong organizational influences at work as well, I would like to keep the critical lens focused for a moment on me (and you) as individuals. I believe that there are insights and lessons from my experience that can help you think about your own likely involvement in issues with ethical overtones.

First, however, a little personal background. In the late 1960s and early 1970s, I was an engineering/MBA

student; I also was an “activist,” engaged in protests of social injustice and the social irresponsibility of business, among other things. I held some pretty strong values, and I thought they would stand up to virtually any challenge and enable me to “do the right thing” when I took a career job. I suspect that most of you feel that you also have developed a strongly held value system that will enable you to resist organizational inducements to do something unethical. Perhaps. Unfortunately, the challenges do not often come in overt forms that shout the need for resistance or ethical righteousness. They are much more subtle than that, and thus doubly difficult to deal with because they do not make it easy to see that a situation you are confronting might actually involve an ethical dilemma.

After school, I got the job of my dreams with Ford and, predictably enough, ended up on the fast track to promotion. That fast track enabled me to progress quickly into positions of some notable responsibility. Within two years I became Ford’s field recall coordinator, with first-level responsibility for tracking field safety problems. It was the most intense, information-overloaded job you can imagine, frequently dealing with some of the most serious problems in the company. Disasters were a phone call away, and action was the hallmark of the office where I worked. We all knew we were engaged in serious business, and we all took the job seriously. There were no irresponsible bureaucratic ogres there, contrary to popular portrayal.

In this context, I first encountered the neophyte Pinto fires problem—in the form of infrequent reports of cars erupting into horrendous fireballs in very low-speed crashes and the shuddering personal experience of inspecting a car that had burned, killing its trapped occupants. Over the space of a year, I had two distinct opportunities to initiate recall activities concerning the fuel tank problems, but on both occasions, I voted not to recall, despite my activist history and advocacy of business social responsibility.



The key question is how, after two short years, could I have engaged in a decision process that appeared to violate my own strong values—a decision process whose subsequent manifestations continue to be cited by many observers as a supposedly definitive study of corporate unethical behavior? I tend to discount the obvious accusations: that my values weren't really strongly held; that I had turned my back on my values in the interest of loyalty to Ford; that I was somehow intimidated into making decisions in the best interest of the company; that despite my principled statements, I had not actually achieved a high stage of moral development; and so on. Instead, I believe a more plausible explanation for my own actions looks to the foibles of normal human information processing.

I would argue that the complexity and intensity of the recall coordinator's job required that I develop cognitive strategies for simplifying the overwhelming amount of information I had to deal with. The best way to do that is to structure the information into cognitive "schemas," or more specifically "script schemas," that guide understanding and action when facing common or repetitive situations. Scripts offer marvelous cognitive shortcuts because they allow you to act virtually unconsciously and automatically, and thus permit you to handle complicated situations without being paralyzed by needing to think consciously about every little thing. Such scripts enabled me to discern the characteristic hallmarks of problem cases likely to result in recall and to execute a complicated series of steps required to initiate a recall.

All of us structure information all of the time; we could hardly get through the workday without doing so. But there is a penalty to be paid for this wonderful cognitive efficiency: we do not give sufficient attention to important information that requires special treatment because the general information pattern has surface appearances that indicate that automatic processing will suffice. That, I think, is what happened to me.

The beginning stages of the Pinto case looked for all the world like a normal sort of problem. Lurking beneath the cognitive veneer, however, was a nasty set of circumstances waiting to conspire into a dangerous situation. Despite the awful nature of the accidents, the Pinto problem did not fit an existing script; the accidents were relatively rare by recall standards, and the accidents were not initially traceable to a specific component failure. Even when a failure mode suggesting a design flaw was identified, the cars did not perform significantly worse in crash tests than competitor vehicles. One might easily argue that I should have been jolted out of my script by the unusual nature of the accidents (very low speed, otherwise unharmed passengers trapped in a horrific fire), but those facts did not penetrate a script cued for other features. (It also is difficult to convey to the lay person that bad accidents are not a particularly unusual feature of the recall coordinator's information field. Accident severity is not necessarily a recall cue; frequently repeated patterns and identifiable causes are.)

**The Corporate Milieu** In addition to the personalized scripting of information processing, there is another important influence on the decisions that led to the Pinto fires mess: the fact that decisions are made by individuals working within a corporate context. It has escaped almost no one's notice that the decisions made by corporate employees tend to be in the best interest of the corporation, even by people who mean to do better. Why? Because the socialization process and the overriding influence of organizational culture provide a strong, if generally subtle, context for defining appropriate ways of seeing and understanding. Because organizational culture can be viewed as a collection of scripts, scripted information processing relates even to organizational-level considerations. Scripts are context bound; they are not free-floating general cognitive structures that apply universally. They are

tailored to specific contexts. And there are few more potent contexts than organizational settings.

There is no question that my perspective changed after joining Ford. In retrospect, I would be very surprised if it hadn't. In my former incarnation as a social activist, I had internalized values for doing what was right—as I understood righteousness in grand terms, but I had not internalized a script for applying my values in a pragmatic business context. Ford and the recall coordinator role provided a powerful context for developing scripts—scripts that were inevitably and undeniably oriented toward ways of making sense that were influenced by the corporate and industry culture.

I wanted to do a good job, and I wanted to do what was right. Those are not mutually exclusive desires, but the corporate context affects their synthesis. I came to accept the idea that it was not feasible to fix everything that someone might construe as a problem. I therefore shifted to a value of wanting to do the greatest good for the greatest number (an ethical value tempered by the practical constraints of an economic enterprise). Doing the greatest good for the greatest number meant working with intensity and responsibility on those problems that would spare the most people from injury. It also meant developing scripts that responded to typical problems, not odd patterns like those presented by the Pinto.

Another way of noting how the organizational context so strongly affects individuals is to recognize that one's personal identity becomes heavily influenced by corporate identity. As a student, my identity centered on being a "good person" (with a certain dose of moral righteousness associated with it). As recall coordinator, my identity shifted to a more corporate definition. This is an extraordinarily important point, especially for students who have not yet held a permanent job role, and I would like to emphasize it. Before assuming your career role, identity derives mainly from social relationships. Upon putting on the mantle of a profession or a responsible

position, identity begins to align with your role. And information processing perspective follows from the identity.

I remember accepting the portrayal of the auto industry and Ford as "under attack" from many quarters (oil crises, burgeoning government regulation, inflation, litigious customers, etc.). As we know, groups under assault develop into more cohesive communities that emphasize commonalities and shared identities. I was by then an insider in the industry and the company, sharing some of their beleaguered perceptions that there were significant forces arrayed against us and that the well-being of the company might be threatened.

What happened to the original perception that Ford was a socially irresponsible giant that needed a comeuppance? Well, it looks different from the inside. Over time, a responsible value for action against corporate dominance became tempered by another reasonable value that corporations serve social needs and are not automatically the villains of society. I saw a need for balance among multiple values, and as a result, my identity shifted in degrees toward a more corporate identity.

**The Torch Passes to You** So, given my experiences, what would I recommend to you, as a budding organizational decision maker? I have some strong opinions. First, develop your ethical base now! Too many people do not give serious attention to assessing and articulating their own values. People simply do not know what they stand for because they haven't thought about it seriously. Even the ethical scenarios presented in classes or executive programs are treated as interesting little games without apparent implications for deciding how you intend to think or act. These exercises should be used to develop a principled, personal code that you will try to live by. Consciously decide your values. If you don't decide your values now, you are easy prey for others who will gladly decide them for you or influence you implicitly to accept theirs.

Second, recognize that everyone, including you, is an unwitting victim of his or her cognitive structuring. Many people are surprised and fascinated to learn that they use schemas and scripts to understand and act in the organizational world. The idea that we automatically process so much information so much of the time intrigues us. Indeed, we would all turn into blithering idiots if we did not structure information and expectations, but that very structuring hides information that might be important—information that could require you to confront your values. We get lulled into thinking that automatic information processing is great stuff that obviates the necessity for trying to resolve so many frustrating decisional dilemmas.

Actually, I think too much ethical training focuses on supplying standards for contemplating dilemmas. The far greater problem, as I see it, is recognizing that a dilemma exists in the first place. The insidious problem of people not being aware that they are dealing with a situation that might have ethical overtones is another consequence of schema usage. I would venture that scripted routines seldom include ethical dimensions. Is a person behaving unethically if the situation is not even construed as having ethical implications? People are not necessarily stupid, ill-intentioned, or Machiavellian, but they are often unaware. They do indeed spend much of their time cruising on automatic, but the true hallmark of human information processing is the ability to switch from automatic to controlled information processing. What we really need to do is to encourage people to recognize cues that build a “Now Think!” step into their scripts—waving red flags at yourself, so to speak—even though you are engaged in essentially automatic cognition and action.

Third, because scripts are context bound and organizations are potent contexts, be aware of how strongly, yet how subtly, your job role and your organizational culture affect the ways you interpret and make sense of information (and thus affect the ways you develop the scripts that will guide you in unguarded

moments). Organizational culture has a much greater effect on individual cognition than you would ever suspect.

Last, be prepared to face critical responsibility at a relatively young age, as I did. You need to know what your values are and you need to know how you think so that you can know how to make a good decision. Before you can do that, you need to articulate and affirm your values now, before you enter the fray. I wasn't really ready. Are you?

## Questions for Discussion

1. The Ford Pinto met federal safety standards, yet it had a design flaw that resulted in serious injuries and deaths. Is simply meeting safety standards a sufficient product design goal of ethical companies?
2. Gioia uses the notion of script schemas to help explain why he voted to not initiate a recall of the Ford Pinto. In your opinion, is this a justifiable explanation?
3. How can organizational context influence the decisions made by organizational members?
4. If you had been in Dennis Gioia's position, what would you have done? Why?
5. Describe the four key decision-making lessons that Dennis Gioia identifies for neophyte decision makers. Discuss how you expect or intend to use these four lessons in your own career.

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# 4

## THE CORPORATION AND EXTERNAL STAKEHOLDERS

### Corporate Governance: From the Boardroom to the Marketplace

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### OPENING CASE

On January 17, 2008, TJX Companies, Inc., a leading retailer in the field of clothing and home fashions which operates stores domestically and internationally, announced that the organization had experienced an unauthorized intrusion of its computer systems.<sup>1</sup> Customer information, including credit card, debit card, and driver's license numbers, had been compromised. This intrusion had been discovered in December

of 2006, and it was thought that data and information as far back as 2003 had been accessed and/or stolen. At the time, approximately 45.6 million credit card numbers had been stolen. In October of 2007, the number rose to 94 million accounts.<sup>2</sup> This has become the largest known credit card theft or unauthorized intrusion in history.

Because of the lax security systems at TJX, the hackers had an open doorway to



the company's entire computer system. In 2005, hackers used a laptop outside of one of TJX's stores in Minnesota and easily cracked the code to enter into the WiFi network. Once in, the hackers were able to access customer databases at the corporate headquarters in Framingham, Massachusetts. The hackers gained access to millions of credit card and debit card numbers, information on refund transactions, and customer addresses and phone numbers. The hackers reportedly used the stolen information to purchase over \$8 million in merchandise.<sup>3</sup>

TJX used an outdated WEP (wired equivalent privacy) to secure its networks. In 2001, hackers were able to break the code of WEPs, which made TJX highly vulnerable to an intrusion. (Similar data breaches have occurred within the past few years at the firms ChoicePoint and CardSystems Solutions.) In August of 2007, a Ukrainian man, Maksym Yastremskiy, was arrested in Turkey as a potential suspect in the TJX case. According to police officials, Yastremskiy is "one of the world's important and well-known computer pirates."<sup>4</sup> He led two other men in the scheme.<sup>5</sup>

Even though the intrusion was discovered in December of 2006, the company did not publicize it until a month later. Consumers felt that they should have been notified of the breach once it was discovered. However, TJX complied with law enforcement and kept the information confidential until it was told it could notify the public. Retail companies such as TJX that use credit card processing are required to comply with the Payment Card Industry Data Security Standard (PCI DSS). The PCI DSS is a set of requirements with the purpose of maximizing the security of credit and debit card transactions. A majority of firms have not complied with this standard, as was the case with TJX Companies.

A number of stakeholders were involved in this break-in: consumers, who were put at great risk; banks; TJX Companies (its shareholders, management, employees, and other internal parties who did business with and were invested in the firm);

the credit card company; the law enforcement and justice systems; the public; other retail firms; and the media, to name a few. CEO Carol Meyrowitz took an active role in informing the public in statements on the company's Web sites and through the media about the company's responsibility and obligations to its stakeholders during and after the investigation. TJX also contacted various agencies to help with the investigation. A Web site and hotline were established to answer customer questions and concerns.

The intrusion cost TJX approximately \$118 million in after-tax cash charges and \$21 million in future charges. Although TJX incurred substantial legal, reimbursement, and improvement costs, the company's pre-tax sales were not negatively affected. Sales during the second quarter of fiscal year 2008 increased compared to second quarter sales from fiscal year 2007.<sup>6</sup>

At the end of 2007, TJX reached a settlement agreement with six banks and bankers' associations in response to a class action lawsuit against the company.<sup>7</sup> In the spring of 2008, TJX settled in separate agreements with Visa (\$40.9 million with 80% acceptance) and MasterCard International (a maximum of \$24 million with 90% minimum acceptance). There was almost full acceptance of the alternative recovery offers by eligible MasterCard accounts.<sup>8</sup> Note that those issuers who accept the agreements and terms release and indemnify TJX" and its acquiring banks on their claims, the claims of their affiliated issuers, and those of their sponsored issuers as MasterCard issuers related to the intrusion. That includes claims in putative class actions in federal and Massachusetts state courts."<sup>9</sup>

Affected customers were reimbursed for costs such as replacing their driver's license and other forms of identification and were offered vouchers at TJX stores and free monitoring of their credit cards for three years. Customer discontent was reportedly expressed after the intrusion; however, customer loyalty returned,<sup>10</sup> as was evidenced in sales numbers.

## 4.1 MANAGING CORPORATE SOCIAL RESPONSIBILITY IN THE MARKETPLACE

“Corporate social responsibility” (CSR) involves an organization’s duty and obligation to respond to its stakeholders’ and the stockholders’ economic, legal, ethical, and philanthropic concerns and issues.<sup>11</sup> This definition encompasses both the social concerns of stakeholders and the economic and corporate interests of corporations and their stockholders. Generally, society cannot function without the economic, social, and philanthropic benefits that corporations provide. Leaders in corporations who use a stakeholder approach commit to serving broader goals, in addition to economic and financial interests, of those whom they serve, including the public.

Managing corporate social responsibility in the marketplace with multiple stakeholder interests is not easy. As discussed in Chapter 3, ethics at the personal and professional levels requires reasoned and principled thinking, as well as creativity and courage. When ethics and social responsibility escalate to the corporate level, where companies must make decisions that affect governments, competitors, communities, stockholders, suppliers, distributors, the public, and customers (who are also consumers), moral issues increase in complexity, as the TJX security breach opening case illustrated. For organizational leaders and professionals, the moral locus of authority involves not only individual conscience but also corporate governance and laws, collective values, and consequences that affect millions of people locally, regionally, and globally.

In the opening case, the TJX executives had to deal not only with their own customers, but with banks (in a class action suit), credit card companies, the media, competitors, and a network of suppliers and distributors—as well as their own reputation. What may have seemed like a routine technical security problem turned into the largest-known credit card theft/unauthorized intrusion in history. Had the CEO not stepped in and become a responsible spokesperson and decision maker for the company, customers may not have responded in kind.

The basis of corporate social responsibility in the marketplace begins with a question: *What is the philosophical and ethical context from which corporate social responsibility and ethical decisions are made?* For example, not everyone is convinced that businesses should be as concerned about ethics and social responsibility as they are about profits. Many believe that ethics and social responsibility are important, but not as important as a corporation’s performance. This classical debate—and seeming dichotomy—between performance, profitability, and “doing the right thing” continues to surface not only with regard to corporate social responsibility, but also in political parties and debates over personal and professional ethics. The roots of corporate social responsibility extend to the topic of what a “free-market” is and how corporations should operate in free markets. Stated another way, does the market sufficiently discipline and weed out inefficient “bad apples” and wrongdoers, thereby saving corporations the costs of having to support “soft” ethics programs?

## ETHICAL INSIGHT 4.1

**Ethical Issues in the TJX Case**

After reading the opening case, answer and be prepared to discuss in class these questions:

1. If you had been assigned to investigate, report, and offer recommendations from this case, how would you respond:
  - (a) Who was to blame for the security breach and why?
2. Which factor, in your judgment, was the most important contributor to TJX's security breach: the lack of a comprehensive security policy and legal procedures OR issues with the company's corporate leadership and culture? Explain.
3. What will work best for TJX in this case: discipline from the legal and judicial system OR required changes in the company's leadership and culture regarding security? Explain.

**Free-Market Theory and Corporate Social Responsibility**

Free-market theory holds that the primary aim of business is to make a profit. As far as business obligations toward consumers, this view assumes an equal balance of power, knowledge, and sophistication of choice in the buying and selling of products and services. If businesses deliver what customers want, customers buy. Customers have the freedom and wisdom to select what they want and to reject what they do not want. Faulty or undesirable products should not sell. If businesses do not sell their products or services, it is their own fault. The marketplace is an arena of arbitration. Consumers and corporations are protected and regulated—according to this view—by Adam Smith's (one of the modern founders of capitalism) notion of the "invisible hand." What would have happened to TJX customers without regulation?

Several scholars argue that Adam Smith's "invisible hand" view is not completely oriented toward stockholders. For example, Eugene Sz wajkowski argues that "Smith's viewpoint is most accurately positioned squarely between those who contend firms should act out of self-interest and those who believe corporations should be do-gooders. This middle ground is actually the stakeholder perspective. That is, stakeholders are in essence the market in all its forms. They determine what is a fair price, what is a successful product, what is an unacceptable strategy, what is intolerable discrimination. The mechanisms for these determinations include purchase transactions, supplier contracts, government regulation, and public pressure."<sup>12</sup> Sz wajkowski continues, "Our own empirical research has clearly shown that employee relations and product quality and safety are the most significant and reliable predictors of corporate reputation."<sup>13</sup>

Economist and free-market advocate Milton Friedman is noted for a philosophical view that is widely known from this quote: "The basic mission of business [is] thus to produce goods and services at a profit, and in doing this,

business [is] making its maximum contribution to society and, in fact, being socially responsible.”<sup>14</sup> Friedman more recently stated that even with the recent corporate scandals, the market is a more effective way of controlling and deterring individual wrongdoers than are new laws and regulations.<sup>15</sup>

Free markets require certain conditions for business activity to help society. These conditions include (1) minimal moral restraints to enable businesses to operate and prevent illegal activities such as theft, fraud, and blackmail; (2) full competitiveness with entry and exit; (3) relevant information needed to transact business available to everyone; and (4) accurate reflection of all production costs in the prices that consumers and firms pay (including the costs of job-related accidents, injuries from unsafe products, and externalities, which are spillover costs that are not paid by manufacturers or companies, but that consumers and taxpayers often pay, e.g., pollution costs). Legal and ethical problems arise when some or all of these conditions are violated, as the corporate crises illustrated at the beginning of this chapter.

## Problems with the Free-Market Theory

Although the free-market theory continues to have its advocates, controversy also exists regarding its assumptions about stakeholders and consumer-business relationships. For example, consider these arguments:

1. Most businesses are not on an equal footing with stakeholders and consumers at large. Large firms spend sizable amounts on research aimed at analyzing, creating, and—some argue—manipulating the demand of certain targeted buyers and groups. Children and other vulnerable groups, for example, are not aware of the effects of advertising on their buying choices.
2. As discussed in Chapter 5, whether many firms’ advertising activities truthfully inform consumers about product reliability, possible product dangers, and proper product use is questioned. A thin line exists between deceit and artistic exaggeration in advertising.
3. The “invisible hand” is often nonexistent for many stakeholders and, in particular, for consumers in need of protection against questionable, poorly manufactured products that are released to market. One reason a stakeholder view has become a useful approach for determining moral, legal, and economic responsibility is that the issues surrounding product safety, for example, are complex and controversial.

Another important argument against free-market theory is based on what economists refer to as *imperfect markets*, that is, markets in which competition “is flawed by the ability of one or more parties to influence prices.”<sup>16</sup> An example of an imperfect market and skewed market power occurs in Africa, “where a few pharmaceutical companies effectively control the availability of several key drugs. In effect, they are beyond the financial means of millions of Africans or their governments. When a few dominating companies cut the prices of several key ingredients of the AIDS cocktail, they demonstrated this power. But this also revealed a further imperfection in the real market, where only rickety systems, if any, exist to deliver the drugs to patients requiring sophisticated and continuous follow-up care.”<sup>17</sup>

**Mixed Market Economies** The debate regarding free markets, imperfect markets, and other forms of social organization is interesting but not always helpful in describing how these systems actually work in the marketplace. The free-market system has been more accurately described by economist Paul Samuelson as a “mixed economy.”<sup>18</sup> Mixed economies include a balance between private property systems and the government laws, policies, and regulations that protect consumers and citizens. In mixed economies, ethics becomes part of legal and business debates. Principles of justice, rights, and duty coexist with utilitarian and market principles.

A realistic approach to managing social responsibility in a mixed market economy is the stakeholder management approach. Instead of separating profit making from social and ethical goals, corporate leaders can accomplish both as the following sections show.

## 4.2 MANAGING CORPORATE RESPONSIBILITY WITH EXTERNAL STAKEHOLDERS

### The Corporation as Social and Economic Stakeholder

The stakeholder management approach views the corporation as a legal entity and also as a collective of individuals and groups. The CEO and top-level managers are hired to maximize profits for the owners and shareholders. The board of directors is responsible for overseeing the direction, strategy, and accountability of the officers and the firm. To accomplish this, corporations must respond to a variety of stakeholders’ needs, rights, and legitimate demands. From this perspective, the corporation has primary obligations to the economic mandates of its owners; however, to survive and succeed, it must also respond to legal, social, political, and environmental claims from stakeholders, as noted earlier. Figure 4.1 illustrates the moral stakes and corporate responsibilities of firms’ obligations toward their different stakeholders.

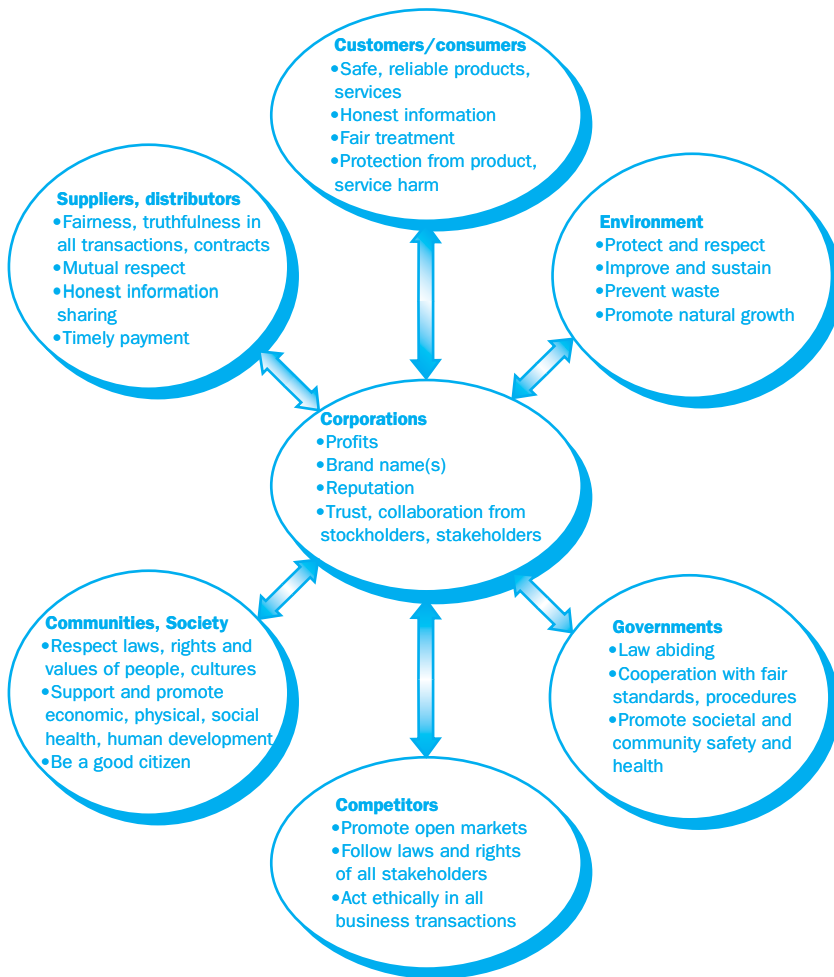
One study argued that “Using corporate resources for social issues not related to primary stakeholders may not create value for shareholders.”<sup>19</sup> This finding does not suggest that corporations refrain from philanthropic activities; rather, “The emphasis on shareholder value creation today should not be construed as coming at the expense of the interests of other primary stakeholders.”<sup>20</sup> Corporations are economic and social stakeholders. This is not a contradiction but a leadership choice that requires balancing economic and moral priorities. In the discussion below, we explore the ethical basis on which the relationships between corporations and their stakeholders are grounded. We then turn to the external compliance and legal dimension of stakeholder management which is also required for effectively dealing with external constituencies.

### The Social Contract: Dead or Desperately Needed?

The stakeholder management approach of the corporation is grounded in the concept of a social contract. Developed by early political philosophers, a social contract is a set of rules and assumptions about behavior patterns among the various elements of society. Much of the social contract is embedded in

Figure 4.1

## External Stakeholders, Moral Stakes, and Corporate Responsibilities



**SOURCE:** Based on the Caux Round Table's Principles for Business. The principles are printed in Business Ethics magazine, 52 S. 10th St. #110, Minneapolis, MN 55403.

the customs of society. Some of the “contract provisions” result from practices between parties. Like a legal contract, the social contract often involves a quid pro quo (something for something) exchange. Although globalization, massive downsizing, and related corporate practices continue to pressure many employer–employee relationships, the underlying principles of the social contract, like mutual trust and collaboration, remain essential.

The social contract between a corporation and its stakeholders is often based on implicit as well as explicit agreements. For example, it is argued that the success of many businesses is directly related to the public's confidence in those businesses. A loss of public confidence can be detrimental

to the firm and to its investors. One way to retain and to reinforce public confidence is by acting in an ethical manner, a manner that shows a concern for the investing public and the customers of the firm.<sup>21</sup> The question is not really whether a social contract between a corporation and its stakeholders exists, but: What is the nature of the contract, and are all parties satisfied with it? Are customers satisfied with the products and services and how they are treated by a company's representatives? Are suppliers, distributors, and vendors all satisfied by the contractual agreements with the corporation? Do members of the communities in which the company is located and serves believe the company is a responsible and responsive citizen? Does the company pay its fair share of taxes? Do employees believe they are paid a fair wage, have adequate working conditions, and are being developed?

## Balance between Ethical Motivation and Compliance

Ethics programs, as part of the social contract, are essential motivators in organizations. Studies suggest that ethics programs matter more than compliance programs on several dimensions of ethics: e.g., awareness of issues, search for advice, reporting violations, decision-making, and commitment to the firm.<sup>22</sup> Business relationships based on mutual trust and ethical principles combined with regulation result in long-term economic gains for organizations, shareholders, and stakeholders.<sup>23</sup> If corporate leaders and their firms commit illegal acts, taxpayers end up paying these costs. Corporate leaders and their stakeholders therefore have an interest in supporting their implicit social contract as well as their legally binding obligations.

There is a balance to be maintained between external regulation and self-regulation based on the public's trust in corporations. An *ABC News/Washington Post* poll found among those surveyed that 63% believe regulation of companies "is necessary to protect the public." Thirty percent reported that regulation "does more harm than good," down 10 percentage points from the 2000 survey. The poll also found that "From Enron to WorldCom, it's been broadly assumed that the recent scandals have shaken confidence in corporate America. In fact such confidence, although low, is no lower than usual. Only 23% of Americans express confidence in business corporations; 75% don't. That's about the same as it was 10 and even 20 years ago."<sup>24</sup>

## Covenantal Ethic

The *covenantal ethic* concept is related to the social contract and is also central to a stakeholder management approach. The covenantal ethic focuses on the importance of relationships—social as well as economic—between businesses, customers, and stakeholders. Relationships and social contracts (or covenants) between corporate managers and customers embody a "*seller must care*" attitude, not only "*buyer beware*."<sup>25</sup> A manager's understanding of problems is measured not only over the short term, in view of concrete products, specific cost reductions, or even balance sheets (though obviously important to a company's results), but also over the long term, in view of the quality of relationships that are created and

sustained by business activity.<sup>26</sup> It may also be helpful to understand the concept of a covenantal ethic in an organizational context by pointing out how great leaders are able to attract and mobilize followers to a vision and beliefs based on the relationship they develop with those being led. Classic leaders like Franklin Roosevelt, John F. Kennedy, and Martin Luther King, Jr. instilled an enduring trust and credibility with their followers. We explain more of these dynamics in Chapter 6; here, the point is that corporate leaders still inspire and motivate followers through their vision, purposive mission, and leading-by-example that result in a type of social contract. Warren Buffet, Bill Gates, and Richard Branson are such examples.

## The Moral Basis and Social Power of Corporations as Stakeholders

Keith Davis argues that the social responsibility of corporations is based on social power, and that “if a business has the power, then a just relationship demands that business also bear responsibility for its actions in these areas.” He termed this view the “iron law of responsibility.” “[I]n the long run, those who do not use power in a manner in which society considers responsible will tend to lose it.” Davis discusses five broad guidelines or obligations business professionals should follow to be socially responsible:

1. Businesses have a social role of “trustee for society’s resources.” Since society entrusts businesses with its resources, businesses must wisely serve the interests of all their stakeholders, not just those of owners, consumers, or labor.
2. Business shall operate as a two-way open system with open receipt of inputs from society and open disclosure of its operations to the public.
3. “Social costs as well as benefits of an activity, product, or service shall be thoroughly calculated and considered in order to decide whether to proceed with it.” Technical and economic criteria must be supplemented with the social effects of business activities, goods, or services before a company proceeds.
4. The social costs of each activity, product, or service shall be priced into it so that the consumer (user) pays for the effects of his consumption on society.
5. Business institutions as citizens have responsibilities for social involvement in areas of their competence where major social needs exist.<sup>27</sup>

These five guidelines provide a foundation for creating and reviewing the moral bases of corporate stakeholder relationships. The public is intolerant of corporations that abuse this mutual trust, as recent surveys show. For example,

- 91% of the public surveyed would consider doing business with another company.
- 85% would tell family and friends about the company.
- 83% would not purchase that company’s stock.
- 80% would not be employed at the company.
- 76% would boycott the company’s services and products.
- 68% would not be as loyal to a job or employment at the company.<sup>28</sup>



The American Customer Satisfaction Index (ACSI) reported the best and worst companies and industries in the first quarter of 2008. The top-rated firms were FedEx Corporation (express delivery), UPS (express delivery), Olive Garden (restaurant), and Southern Company (utility). The lowest rated were US Airways (airlines), Charter Communications (cable and satellite TV), Comcast Corporation (cable and satellite TV), and Sprint Nextel (wireless telephone services). Those companies that showed the largest decline since 2007 included US Airways (airlines), Continental Airlines (airlines), Sprint Nextel (wireless telephone services), and Northwest Airlines (airlines). The top-rated industries were express delivery and ambulatory care; the lowest rated were airlines, cable and satellite TV, and newspapers. Broadcast news and newspapers showed the largest decline since the past year. While economic, environmental, and other factors affect customer satisfaction with companies and industries—especially those listed in this survey at this time—if an industry or company continues to score low on the index, it should serve as a wakeup call to the stockholders and corporate leaders. Many times some element of poor stakeholder management can also be part of the problem, whether perceived or experienced.<sup>29</sup>

### Corporate Philanthropy

A corporation's social responsibility also includes philanthropic responsibilities in addition to its economic, legal, and ethical obligations. Corporate philanthropy is an important part of a company's role as "good citizen" at the global, national, and local levels. The public expects, but does not require, corporations to contribute and "give back" to the communities that support their operations. Procter & Gamble's reputation has been enhanced by its global contributions. Some of the greatest corporate philanthropists include Warren Buffet, who has donated some \$37 billion in shares of his own company, Berkshire Hathaway, to five charitable foundations<sup>30</sup> (the Bill & Melinda Gates Foundation is one of the five, and will receive \$31 billion for global health and education projects); Ted Turner of Time Warner, who has given \$1 billion to the United Nations; Bill Gates of Microsoft, who has provided \$100 million to control AIDS/HIV in India; Kathryn Albertson of Albertson's Grocery, who has contributed in excess of \$600 million to support public education in Idaho; and George Soros, the preeminent global investor, who has donated more than \$525 million to assist Russian health and education programs and U.S. drug and education programs.<sup>31</sup> Although corporate social responsibility and values-based, principled leadership are necessary elements for sustaining ethical stakeholder business relationships, effective regulation and strong corporate governance are also required.

### Managing Stakeholders Profitably and Responsibly: Reputation Counts

Globalization and the shifting centers of financial power and influence, the ongoing diffusion of information technology, and the threat of other Enrons continue to pressure corporate competition, along with increasingly wider shareholder activism. "The result is that many employees, investors,

## ETHICAL INSIGHT 4.2

Are salary, benefits, and career promotion worth more to you than working in an ethical company for responsible leaders and managers with stimulating intellectual opportunities?

A survey conducted by David Montgomery of Stanford and Catherine Ramus of UC Santa Barbara of more than 800 MBAs from 11 major North American and European schools reported that “the financial package was only 80% as important as intellectual challenge.” “Reputation for ethics and caring about employees” was almost 77% as important as the top criterion of “intellectual challenge.” More than 97% reported that they would forego important financial benefits to work for an organization that had a better reputation for corporate social responsibility and ethics. MBAs reported a willingness to give up to 14% of their expected income for a company’s

reputation for ethics and social responsibility.

Career management professionals in 26 countries reported that 82% said corporate leadership ethics was significantly important to job seekers.

### Questions

1. Do you agree or disagree with the results of the MBA survey? Explain.
2. How would you rank the following in order of importance (1 = most important; 4 = least important)?
  - \_\_\_ Financial package
  - \_\_\_ Ethical reputation of organization
  - \_\_\_ Intellectual stimulation of the job
  - \_\_\_ Care for employees by leaders and managers
3. Explain your ranking.

**SOURCE:** Stanford Graduate School of Business Press Release. (July 26, 2004). Stanford Business School study finds MBA graduates want to work for caring and ethical employers. Ethical Corporation Online, <http://www.csrwire.com/ethicalcorporation/article.cgi/2910.html>.

and consumers are seeking assurances that the goods and services they are producing, financing, or purchasing are not damaging to workers, the environment, or communities by whom and where they are made.”<sup>32</sup> There is, consequently, renewed interest in the area of corporate social responsibility (CSR)—i.e., how a business respects and responds responsibly to its stakeholders and society as well as to its stockholders.<sup>33</sup>

Most executives and professionals are interested in their stakeholders and are law abiding. Reputation remains one of the most powerful assets in determining the extent to which a company manages its stakeholders effectively. There is also evidence that socially responsible corporations have a competitive advantage in the following areas:

1. Reputation.<sup>34</sup>
2. Successful social investment portfolios.<sup>35</sup>
3. Ability to attract quality employees.<sup>36</sup>

The organization Business Ethics ranks the top 100 socially responsible corporations in terms of citizenship. Business Ethics uses its own collected data, including the Domini 400 Social Index (which also tracks, measures, and publishes information on companies that act socially responsible). The Standard & Poor 500 plus 150 publicly owned companies are ranked on a scale that measures stakeholder ratings. Harris Interactive Inc. and Reputation Institute, a New York-based research group, conducted an online nationwide survey of 10,830 people to identify the companies with the best corporate reputations among Americans at the turn of the millennium.<sup>37</sup> The Reputation Quotient (RQ) is a standardized instrument that measures a company's reputation by examining how the public perceives companies based on 20 positive attributes, including emotional appeal; social responsibility; good citizenship in its dealings with communities, employees, and the environment; the quality, innovation, value, and reliability of its products and services; how well the company is managed; how much the company demonstrates a clear vision and strong leadership; and profitability, prospects, and risk.

The executive director of the Reputation Institute, Anthony Johndrow, noted, "Reputation is much more than an abstract concept; it's a corporate asset that is a magnet to attract customers, employees, and investors."<sup>38</sup> Google took top place in the Reputation Institute's annual Global Pulse U.S. 2008 study. "The study measures the overall respect, trust, esteem, and admiration consumers hold towards the largest 600 companies in the world, including the largest 150 U.S. companies. Governance and citizenship combined account for more than 30% of a company's reputation." Also, "The Global Pulse 2008 offers insight on how reputation impacts and influences a company's stakeholders—and its bottom line. 'When people trust, admire and have a good feeling about a company, they are willing to support and recommend the company to others,' explains Johndrow of the significant value of reputation. 'We see a strong pattern between reputation and support, demonstrating that building a favorable reputation platform should be a part of a company's overall strategy,' he stated."<sup>39</sup> The top twenty-five "best corporate reputations in the U.S." are listed in Table 4.1.

You can score your own organization's reputation in Ethical Insight 4.3, "Rank Your Organization's Reputation."

#### 4.3 MANAGING AND BALANCING CORPORATE GOVERNANCE, COMPLIANCE, AND REGULATION

While leaders and their teams build the reputations of their corporations through high productivity, trust, and good deeds shown toward their stakeholders while satisfying competitive demands of the marketplace, it is also true that laws and regulations set standards for acceptable and unacceptable business practices and behaviors. Just as the market is not entirely "free," neither are all stakeholders and constituencies honest, fair, and just in their motives and business transactions. The corporate scandals exemplified by Enron and others demonstrated that entire corporations can be brought down by top-level executives and their teams. Lessons from the scandals

Table 4.1

**2008 Best Corporate Reputations in the U.S.**

- |                          |                                |
|--------------------------|--------------------------------|
| 1. Google                | 14. FedEx                      |
| 2. Johnson & Johnson     | 15. Deere & Co                 |
| 3. Kraft Foods Inc.      | 16. Goodyear                   |
| 4. General Mills         | 17. Apple                      |
| 5. Walt Disney           | 18. Hewlett-Packard            |
| 6. United Parcel Service | 19. Intel                      |
| 7. 3M                    | 20. Publix Super Markets, Inc. |
| 8. Xerox                 | 21. Caterpillar                |
| 9. Colgate-Palmolive     | 22. Whirlpool                  |
| 10. Texas Instruments    | 23. Boeing                     |
| 11. Eastman Kodak        | 24. Costco Wholesale           |
| 12. General Electric     | 25. Dell                       |
| 13. Sara Lee             |                                |

**SOURCE:** The Most Respected Companies in the United States—Reputation Institute Releases Results of its Global Pulse U.S. 2008, June 4, 2008, [http://fe56.news.sp1.yahoo.com/s/prweb/20080604/bs\\_prweb/prweb958934](http://fe56.news.sp1.yahoo.com/s/prweb/20080604/bs_prweb/prweb958934).

**ETHICAL INSIGHT 4.3****Rank Your Organization's Reputation**

Score a company, college, or university at which you worked or studied on the following characteristics. Be objective. Answer each question based on your experience and what you objectively know about the company (college or university).

1 = very low; 2 = somewhat low;  
3 = average; 4 = very good; 5 = excellent

\_\_\_ Emotional appeal of the organization for me

\_\_\_ The social responsibility of the organization

\_\_\_ The organization's treatment of employees, community, and environment

\_\_\_ The quality, innovation, value, and reliability of the organization's products and/or services

\_\_\_ The clarity of vision and strength of the organization's leadership

\_\_\_ The organization's profitability, prospects in its market, and handling of risks

\_\_\_ Total your score

Interpretation: Consider 30 a perfect score; 24 very good; 18 average; 12 low; and 6 very low.

1. How did your company do on the ranking? Explain.

2. Explain your scoring on each item; that is, give the specific reasons that led you to score your company on each item as you did.

3. Suggest specific actions your organization could take to increase its Reputation Quotient.

also showed that corporate boards of directors, CEOs (chief executive officers), CFOs (chief financial officers), and other top-level administrators require legal constraints, compliance rules, regulation, and the threat and provision of punishment when crimes are committed. Wrongdoers inside and outside corporations must have boundaries set and disciplinary actions applied not only to protect the innocent, but also to enable businesses to exist and succeed. The “rule of law” enables capitalism and democracies to thrive. Research also shows that both a “carrot” (motivational, ethical incentives) and “stick” (legal compliance and potential disciplinary action) approaches are necessary to enable workforces and leaders to be productive and law abiding. Figure 4.2 illustrates a “carrot and stick” balancing approach that effective corporations use in providing both a legal and ethical culture and transactions, internally and with external stakeholders, as shown back in Figure 4.1.

In this section, we discuss the “stick” approach (legal compliance and regulation) in more detail. With our focus here on the corporation and external stakeholders, we limit our discussion of laws to (1) the Sarbanes-Oxley Act (SOX), and a brief overview of the (2) Federal Sentencing Guidelines for Organizations (FSGO), and then discuss (3) laws regulating competition, consumer protection, employment discrimination/pay/safety, and the environment. Chapter 5 covers legal and social issues related to the corporation and consumer stakeholders and Chapter 7 addresses employee stakeholders.

Most corporations effectively govern themselves, to a large extent, through their own control systems and stakeholder relationships. A public corporation’s federal and state charters provide the legal basis for its board of directors, stockholders, and officers to govern and operate the company.<sup>40</sup> However, as Enron and other corporate scandals demonstrated, self-governance cannot be counted on to work well alone. A question often repeated from the scandals was, “Where were the boards of directors when the widespread fraud, deception,



and abuse of power occurred?” The U.S. Senate’s Permanent Subcommittee of Investigation of the Committee on Governmental Affairs stated,

The flagrant failure of Enron’s board of directors is a warning we must heed. The more than 100 million people whom we call the new investor class, those middle-class Americans who entered the market in the 1990s, were shaken by the scandals. Investors are asking: If the distinguished Enron board failed so utterly in this case, how many other boards might be negligent?<sup>41</sup>

There are a number of reasons cited why many of the larger, prominent corporate boards of directors did not execute their mandated legal and ethical responsibilities, including lack of independence, insider roles and relationships, conflicts of interest, overlapping memberships of board members with other boards, decision-by-committees, well-paid members with few responsibilities, and lack of financial expertise and knowledge about how companies really operate.<sup>42</sup>

## Top Ten Companies: Best Corporate Board Governance Practices

Most corporate boards act responsibly toward their stakeholders and in the best interests of shareholders. Ten of the top twenty-five companies that scored highest in their industries for corporate governance practices are summarized here, including some of those “best practices.” The list is produced by *Crain’s New York Business*.<sup>43</sup>

Experts at RiskMetrics Group analyzed corporate governance practices at the largest 25 public companies in New York City. The analysis includes over 180 data items. Among the criteria that counted most were audit committee structures, succession plans, and restatements of financial results within the past two years. Crain’s then assigned a grade to each company based on how that firm compared with all companies in the S&P 500. Companies that were in the top 20% received an A, those in the second 20% a B, and so. Ten of the top twenty-five are summarized here, with each firm’s score and an abbreviated summary of its strengths and weakness with regard to corporate governance best practices.

The following section discusses the two laws best known for defining the regulations and best practices for companies and their boards of directors.

Figure 4.3

### Top 10 Companies and Best Corporate Board Practices

1. **Citigroup Inc.:** scored better than 98% of companies in diversified financials  
Revenues: \$146.9 billion  
High marks for its audit committee; all members are seen as “financial experts.” On the downside, it issues a lot of stock options to its leaders.

(continued)

● Figure 4.3

### Top 10 Companies and Best Corporate Board Practices (*continued*)

2. **American International Group Inc.:** scored better than 79.5% of insurance companies  
 Revenues: \$113.5 billion  
 Corporate governance is improving, though not as fast as companies in other industries. Company's compensation packages are "badly aligned"; firm is a high-risk factor for future litigation and liability. Firm also lacks stock ownership guidelines.
3. **J.P. Morgan Chase & Co.:** scored better than 96.7% of companies in diversified financials  
 Revenues: \$99.3 billion  
 A simple majority vote of shareholders can amend the bank's charter or bylaws and approve of mergers. The company's burn rate is in the high range, and its executive compensation was judged excessive.
4. **IBM Corp.:** scored better than 88.3% of technology companies  
 Revenues: \$91.4 billion  
 Board is controlled by a supermajority of independent outsiders. IBM's chairman and chief executive positions are joint. Executive compensation was judged excessive. The company lacks a board-approved chief executive succession plan.
5. **Verizon Communications Inc.:** scored better than 98.3% of telecom companies  
 Revenues: \$88.1 billion  
 The company's board is run by a supermajority of independent outsiders. Financial experts make up its audit committee. Downside is that its stock-based incentive plans were adopted without shareholder approval.
6. **Morgan Stanley:** scored higher than 95.3% of diversified financials firms  
 Revenues: \$76.6 billion  
 Outside directors meet without the chief executive present—a plus by good-governance standards. But the firm does not use performance-based equity awards for which specific criteria are disclosed, and its compensation was judged excessive.
7. **Altria Group Inc.:** scored better than 82.1% of food, beverage and tobacco companies  
 Revenues: \$70.3 billion  
 Full board is elected annually. The directors are not subject to stock ownership guidelines—a major flaw for corporate governance experts. The company paid its auditor a relatively large sum for non-audit services, calling the objectivity of the audit into question.
8. **Goldman Sachs Group Inc.:** outscored 90% of diversified financial companies  
 Revenues: \$69.4 billion  
 Independent outsiders make up the nominating and compensation committees. All the company's audit committee members are

Figure 4.3

### Top 10 Companies and Best Corporate Board Practices (*continued*)

financial experts. Has a low burn rate, but it has takeover defenses and excessive executive compensation that lower its score.

9. **Merrill Lynch & Co.:** scored better than 82% of diversified financial companies

Revenues: \$68.6 billion<sup>44</sup>

Board is controlled by a supermajority of outsiders. Firm's stock-based incentive plans have been adopted without shareholder approval. It also has some takeover defenses, and its board members serve three-year terms, making them less accountable. Its executive compensation has been judged excessive, and moves that might benefit shareholders, such as a merger, require a supermajority vote.

10. **MetLife Inc.:** scored higher than 76.7% of other insurers

Revenues: \$48.4 billion

Outside directors meet separately without the chief executive—a plus. Board performance is regularly reviewed. But the firm's takeover defenses are high, and its board members are elected every three years—a practice that inhibits the board from being as accountable as it could be.

## Sarbanes-Oxley Act

The 2002 Sarbanes-Oxley Act was a direct regulatory response by Congress to corporate scandals. (PricewaterhouseCoopers called this law the most important legislation affecting corporate governance, financial disclosure, and public accounting practice since the 1930s.)<sup>45</sup> The “carrot” approach, or corporate self-regulation, did not work for Enron and other firms involved in scandals; Congress realized that a “stick” approach (laws, regulations, disciplinary actions) was also required. A summary of the Sarbanes-Oxley Act shows that federal provisions were established to provide oversight, accountability, and enforcement of truthful and accurate financial reporting in public firms. Some of the major issues included (1) a lack of an independent public company accounting board to oversee audits; (2) conflicts of interest in companies serving as auditors and management consultants to companies; (3) holding top-level officers (CEOs and CFOs) accountable for financial statements; (4) protecting whistle-blowers; (5) requiring ethics codes for financial officers; and (6) other reforms as the list below shows.

The key sections of the Act are summarized as follows:

- Establishes an independent public company accounting board to oversee audits of public companies.
- Requires one member of the audit committee to be an expert in finance.
- Requires full disclosure to stockholders of complex financial transactions.



- Requires CEOs and CFOs to certify in writing the validity of their companies' financial statements. If they knowingly certify false statements, they can go to prison for 20 years and be fined \$5 million.
- Prohibits accounting firms from offering other services, like consulting, while also performing audits. This constitutes a conflict of interest.
- Requires ethics codes for financial officers that is registered with the Securities and Exchange Commission (SEC).
- Provides a 10-year penalty for wire and mail fraud.
- Requires mutual fund professionals to disclose their vote on shareholder proxies, enabling investors to know how their stocks influence decisions.
- Provides whistle-blower protection for individuals who report wrongful activities to authorities.
- Requires attorneys of companies to disclose wrongdoings to senior officers and to the board of directors, if necessary; attorneys should stop working for the companies if senior managers ignore reports of wrongdoings.<sup>46</sup>

The Sarbanes-Oxley Act of 2002 also defines several reforms aimed at improving problems of boards of directors.

There are other “best practices” guidelines for boards, including:

1. Separating the role of chairman of the board when the CEO is also a board member
2. Setting tenure rules for board members
3. Regularly evaluating itself and the CEO's performance
4. Prohibiting directors from serving as consultants to the companies which they serve
5. Compensating directors with both cash and stock
6. Prohibiting retired CEOs from continuing board membership
7. Assigning independent directors to the majority of members who meet periodically without the CEO<sup>47</sup>

The roles and responsibilities of CEOs and organizational leaders are discussed in Chapter 6.

## Pros and Cons of Implementing the Sarbanes-Oxley Act

Critics of Sarbanes-Oxley argue against the implementation and maintenance of the law for the following reasons:

### Arguments “against”

1. It is too costly. One estimate from a survey by Financial Executives International stated that firms with \$5 billion in revenue could expect to spend on average \$4.7 million implementing the internal controls required, then \$1.5 million annually to maintain compliance.<sup>48</sup> An average first year cost for complying with Section 404 of the Act (i.e., creating reliable internal financial controls and having management and an independent auditor confirm the reliability) was estimated at \$4.36 million.<sup>49</sup> Others argue that the costs exceed the benefits,

especially for small firms. “Smaller companies that are audited by the Big Four will have to pay higher audit fees even if they are not subject to Sarbanes-Oxley as the additional audit requirements of Sarbanes-Oxley creep into their methodologies. Many private companies and smaller public companies are realizing that the Big Four have designed their audits to serve the *Fortune* 500 companies and that this model is slow and expensive.”<sup>50</sup>

2. It impacts negatively on a firm’s global competitiveness. This argument is also based on the costs of keeping internal operations compliant with the act. Critics argue that other companies around the globe do not have this expense, so why should U.S. public firms?
3. Government costs also increase to regulate the law.
4. CFOs are overburdened and pressured by having to enforce and assume accountability required by the law.
5. Critics claim that implementing Sarbanes-Oxley requirements throughout an organization is too costly and wasteful for small and mid-sized firms wishing to go public.

Paul Volcker and Arthur Levitt, two widely respected experts previously from the SEC and Federal Reserve respectively, offered the following counterclaims to some of the previous criticisms:<sup>51</sup>

#### Arguments “for”

1. The costs of implementing Sarbanes-Oxley are minimal compared to the costs of not having it—recall the \$7 trillion in stock losses alone, not counting the damage done to employee families and effects on the economy at large.
2. “Companies have better internal control environments as a result of Sarbanes-Oxley. This will lead to more accurate information being available to investors who are more confident in making investing decisions. All participants in financial reporting have increased responsibilities and consequences for not living up to those responsibilities.”<sup>52</sup>
3. The changes required to implement this law are difficult; however, a recent *Corporate Board Member* magazine survey that found more than 60% of 153 directors of corporate boards of directors believe the effect of Sarbanes-Oxley has been positive for their firms, and that more than 70% viewed the law as also positive for their boards.<sup>53</sup>
4. The data does not support the argument that this law presents a competitive disadvantage to global firms. The NASDAQ stock exchange has added six international listings in the second quarter of 2004. A recent survey by Broadgate Capital Advisors and the Value Alliance found that only 8% of 143 foreign companies that issue stocks that trade in the United States claimed that Sarbanes-Oxley would cause them to rethink entering the U.S. market.<sup>54</sup>
5. If a company uses the Sarbanes-Oxley Act as a reason to not go public, the firm should not go public or use investors’ funds. U.S. markets are among the most admired in the world because they are the best regulated.
6. Financial officers who complain about the requirements of Sarbanes-Oxley may in fact be suffering from the lack of internal controls they

had before. In 2003, 57 companies of all sizes said they had material weaknesses in their controls, after their auditors, who were paid to test financial controls, were terminated. These same auditors decreased their testing of internal controls because they faced pressures to cut their fees.

The costs and benefits of implementing Sarbanes-Oxley continue to be debated. Still, Paul Volcker and Arthur Levitt argue that, “While there are direct money costs involved in compliance, we believe that an investment in good corporate governance, professional integrity, and transparency will pay dividends in the form of investor confidence, more efficient markets, and more market participation for years to come.”<sup>55</sup> Certainly guidelines and specific ways to simplify, decrease unnecessary costs, and streamline implementation of this law must be addressed as companies strive to compete locally, nationally, and especially globally.

### **Revised 1991 Federal Sentencing Guidelines: Compliance Incentive**

Before the 2002 Sarbanes-Oxley Act, the 1991 Federal Sentencing Guidelines were passed to help federal judges set and mitigate sentences and fines in companies that had a few “bad apples” who had committed serious crimes. The guidelines were also designed to alleviate sentences on companies that had ethics and compliance programs. Under these guidelines, a corporation (large or small) receives a lighter sentence and/or fine—or perhaps no sentence or probation—if convicted of a federal crime, provided that the firm’s ethics and compliance programs were judged to be “effective.” The guidelines changed the view of corporations as entities that were legally liable and punishable for criminal acts committed within their boundaries to the view of the corporation as a moral agent responsible for the behavior of its employees. As a moral agent, the corporation could be evaluated and judged on how effective the leaders, culture, and ethics training programs were toward preventing misconduct and crime.<sup>56</sup>

Companies that acted to prevent unethical and criminal acts would, under the guidelines, be given special consideration by judges when being fined or sentenced. A point system was established to help mitigate the fine and/or sentence if the company displayed the following seven criteria:

1. Established standards and procedures capable of reducing the chances of criminal conduct
2. Appointed compliance officer(s) to oversee plans
3. Took due care not to delegate substantial discretionary authority to individuals who are likely to engage in criminal conduct
4. Established steps to effectively communicate the organization’s standards and procedures to all employees
5. Took steps to ensure compliance through monitoring and auditing
6. Employed consistent disciplinary mechanisms
7. When an offense was detected, took steps to prevent future offenses, including modifying the compliance plan, if appropriate.<sup>57</sup>

The guidelines have been revised to reflect the post-Enron corporate environment. The revisions add specificity to the 1991 version, include top-level officers' accountability, and attempt to increase the effectiveness and integration of a company's ethics and compliance programs with its culture and operations. Ed Petry, former director of the Ethics Officer Association (EOA), served on the federal committee that revised the guidelines. Petry summarized some of the prominent revisions to the guidelines as follows<sup>58</sup>:

- Compliance and ethics programs (C&EP) are now described in a stand-alone guideline.
- The connection between effective compliance and ethical conduct is stressed.
- Organizations are required to “promote an organizational culture that encourages ethical conduct and a commitment to compliance with the law.”

The Sarbanes-Oxley Act of 2002 and the 2004 Revised Federal Sentencing Guidelines serve as constraints and deterrents to immoral and criminal corporate conduct that ultimately affects stakeholders and stockholders.

Table 4.2 shows the revised FSGO guidelines. The Sarbanes-Oxley Act is an attempt by the U.S. federal government to provide stricter compliance guidelines and disciplinary actions to corporations in the wake of

Table 4.2

### FSGO (Federal Sentencing Guidelines for Organizations) 2004 Revised

1. Exercise due diligence to prevent and detect criminal conduct.
2. Promote an **organizational culture** that encourages ethical conduct and a commitment to compliance with the law.
3. The organization shall use reasonable efforts **not to include within the substantial authority personnel** of the organization **any individual whom the organization knew**, or should have known through the exercise of due diligence, **has engaged in illegal activities** or other conduct **inconsistent with an effective compliance and ethics program**.
4. (A) The organization shall take reasonable steps to **communicate periodically and in a practical manner its standards and procedures**, and other aspects of the compliance and ethics program, to the individuals referred to in subdivision (B) by **conducting effective training programs** and otherwise **disseminating information appropriate to such individuals' respective roles and responsibilities**.  
(B) The individuals referred to in subdivision (A) are the members of the governing authority, high-level personnel, substantial authority personnel, the organization's employees, and, as appropriate, the organization's agents.

(continued)

Table 4.2

### FSGO (Federal Sentencing Guidelines for Organizations) 2004 Revised (*continued*)

5. The organization shall take reasonable steps—
  - (A) to ensure that the organization’s compliance and ethics program is followed, including monitoring and auditing to detect criminal conduct;
  - (B) to evaluate periodically the effectiveness of the organization’s compliance and ethics program;
  - (C) to have and **publicize a system**, which may include mechanisms that **allow for anonymity or confidentiality**, whereby the **organization’s employees and agents may report or seek guidance** regarding potential or actual criminal conduct without fear of retaliation.
6. The **organization’s compliance and ethics program shall be promoted and enforced consistently throughout the organization** through (A) appropriate incentives to perform in accordance with the compliance and ethics program; and (B) appropriate disciplinary measures for engaging in criminal conduct and for failing to take reasonable steps to prevent or detect criminal conduct.
7. After criminal conduct has been detected, the organization shall take reasonable steps to respond appropriately to the criminal conduct and to prevent further similar criminal conduct, including making any necessary modifications to the organization’s compliance and ethics program.

**SOURCE:** 2004 Federal Sentencing Guidelines, Chapter 8—part B—Remedying harm from criminal conduct, and effective compliance and ethics program<sup>2</sup> effective compliance and ethics program, §8B2.1. Effective Compliance and Ethics Program.

corporate scandals. The revised FSGO add incentives to companies to self-regulate while following laws aimed at protecting the interests of shareholders and stakeholders, including the public. In the following section, an overview of the role laws and congressional agencies play in protecting the public, consumers, and other stakeholders is provided.

## 4.4 THE ROLE OF LAW AND REGULATORY AGENCIES AND CORPORATE COMPLIANCE

Government at the federal, state, and local levels also regulates corporations through laws, administrative procedures, enforcement agencies, and courts. Regulation by the government is necessary in part because of failures in the free-market system discussed earlier. There are also power imbalances between corporations, individual consumers, and citizens. Individual citizens and groups in society need a higher authority to represent and protect their interests and the public good.<sup>59</sup>

The role of laws and the legal regulatory system governing business serves five purposes:

1. Regulate competition.
2. Protect consumers.
3. Promote equity and safety.
4. Protect the natural environment.
5. Ethics and compliance programs to deter and provide for enforcement against misconduct.<sup>60</sup>

The corporate scandals again exemplified a failure of internal corporate governance and self-regulation by all parties (internal and external to corporations) involved. Individual leaders' greed, ineffective boards, investment banks, and financial companies and traders all conspired with Enron and other companies in the scandals to commit fraud, theft, and deceit. Corporate scandals cannot be initiated and sustained without the direct or indirect assistance and/or negligence from the SEC (Security Exchange Commission), banks, investment traders and managers, media, Wall Street, federal legislators, and other players.<sup>61</sup> The current subprime lending crisis also shows how an entire system of stakeholders in the financial, banking, credit and lending system, and government are involved in a crisis that has been attributed in large part to "predatory lending" practices. As with the corporate scandals, in the subprime crisis one asks, "Where were the federal, state, and local governmental and congressional regulators?" Still, the justice system did serve sentences to executives in the corporate scandals. Starting with Enron and followed by WorldCom, Qwest, Tyco, HealthSouth, and others, more than \$7 trillion in stock market losses were accrued. These losses also cost American employees and families more than 30% of their retirement savings.<sup>62</sup> A quick summary illustrates the aftermath of some of the major scandals.

- Enron Corporation: Former chairman and CEO Ken Lay died before being tried and sentenced. Jeffrey Skilling, a former executive, pleaded not guilty to fraud, conspiracy, insider trading, and other federal counts and received a 24-year prison sentence. The former CFO, Andrew Fastow, pleaded guilty to two counts of conspiracy and agreed to cooperate with prosecutors. He received a 10-year sentence and the forfeiture of over \$20 million.
- WorldCom Inc.: Former CEO Bernard Ebbers pleaded not guilty to fraud and conspiracy charges for allegedly leading an accounting fraud estimated at more than \$11 billion. He was sentenced to 25 years. Scott Sullivan, former CFO, pleaded guilty to fraud charges, testified against Ebbers, and received a five-year prison sentence.
- Tyco International Ltd.: Former CEO Dennis Kozlowski and CFO Mark Swartz were accused of stealing \$600 million from the company. A New York state judge declared a mistrial in the case because of pressure on a jury member. Dennis Kozlowski received a sentence of  $8\frac{1}{3}$  to 25 years in prison. Both Kozlowski and Swartz could be eligible for parole after six years, 11 months.

- **Adelphia Communications Corporation:** Founder John Rigas was convicted and sentenced to 15 years; his son Timothy received 20 years for conspiracy and bank and securities fraud. Rigas' other son Michael was acquitted of conspiracy charges.
- **Credit Suisse First Boston:** Frank Quattrone, a former investment banking executive who made millions helping Internet companies go public during the dot-com boom, was convicted of obstruction of justice and sentenced to 18 months. His first trial in 2003 ended in a hung jury.
- **HealthSouth Corporation:** Former CEO Richard Scrushy was federally charged with leading a multibillion-dollar scheme that inflated HealthSouth earnings to show the company was meeting Wall Street forecasts. Sixteen former HealthSouth executives were charged as part of a conspiracy to inflate company earnings. Scrushy is the only executive who has not pleaded guilty and is not cooperating with investigators.
- **Martha Stewart,** founder of Martha Stewart Living Omnimedia, was convicted of conspiracy, obstruction of justice, and lying about her personal sale of ImClone Systems shares. She was refused a new trial on perjury charges against a government witness. Stewart was sentenced to five months in prison. Her broker, Peter Bacanovic, was fined \$2,000.
- **Samuel D. Waksal,** founder and former CEO of ImClone Systems, was sentenced to seven years in prison for securities fraud, perjury, and other crimes he committed with ImClone stock trades to himself, his father, and his daughter at the end of 2001.
- **Qwest Communications International, Inc.:** Denver federal prosecutors did not win a conviction against four former mid-level executives accused of scheming to deceptively book \$34 million in revenue for the company. Grant Graham, former chief financial officer for Qwest's global business unit; Bryan Treadway, a former assistant controller; Thomas Hall, a former senior vice president; and John Walker, a former vice president, were found not guilty on 11 charges of conspiracy, securities fraud, wire fraud, and making false statements to auditors. Thomas Hall received probation and paid a \$5,000 fine.<sup>63</sup>

## Why Regulation?

While governmental legislation and oversight of corporations is an imperfect system, one can always ask, "Would you rather live in a system where these laws and controls did not exist?" It is also important to note here, as Figure 4.2 shows, that laws are designed to protect and prevent crime and harm, monopolies, and the negative ("externalities") effects of corporate activities (pollution, toxic waste), and to also promote social and economic growth, development, and the health, care and welfare of consumers and the public. Laws provide a baseline, boundaries, and minimum standards for distinguishing acceptable from unacceptable business practices and behaviors. Values, motivations, beliefs, and incentives to do what is right are also necessary in corporations as they are in society and other institutions. The legal and regulatory system is necessary in society and business to establish

ground rules and boundaries for transactions. It is not, however, sufficient alone to accomplish this task. The second observation to keep in mind in this discussion is that even with federal, state, and local laws, governmental regulatory agencies in contemporary capitalist democracies are part of political systems—where lobbyists and interest groups compete for resources, influence, and programs for their own ends. In such systems, the legislative and judicial branches of government are designed to provide arbitration and conflict resolution with law enforcement. The following regulatory agencies serve educational as well as legal purposes for corporations serving consumers in the marketplace.

## Laws and U.S. Regulatory Agencies

Some of the major laws promoting and prohibiting **corporate competition** include:

- Sherman Antitrust Act, 1890: Prohibits monopolies, as the recent case of Microsoft illustrates.
- Clayton Act, 1914: Prohibits price discrimination, exclusivity, activities restricting competition.
- Federal Trade Commission Act, 1914: Enforces antitrust laws and activities.
- Consumer Good Pricing Act, 1975: Prohibits price agreements in interstate commerce between manufacturers and resellers.
- FTC Improvement Act: Empowers the FTC to prohibit unfair industry activities.
- Antitrust Improvements Act, 1976: Supports existing antitrust laws and empowers Justice Department investigative authority.
- Trademark Counterfeiting Act, 1980: Gives penalties for persons violating counterfeit laws and regulations.
- Digital Millennium Copyright Act, 1998: Protects digital copyrighted material such as music and movies.

Examples of how some of these laws operate in the U.S. include the Microsoft case in this text. While this company battles on with its antimonopoly case in the U.S., it has not fared as well against the EU (European Union) justice system, as the case in Chapter 1 illustrated. Also, as the opening case in Chapter 1 showed, the disagreements and court cases surrounding alleged copyright violations of online file sharing continue to play out among a host of stakeholders, including university students and even younger, Internet-savvy individuals. And, as discussed in Chapter 2, stakeholder and issues management approaches are needed to understand how these and other laws evolve, are disputed, and the competing claims resolved.

## Laws Protecting Consumers

Consumers require information and protection with products that may be unsafe, unreliable, and even dangerous, as Chapter 5 will show. Certainly tobacco products have proven fatal for many people over the decades. As the opening case in Chapter 2 illustrates, toys assembled in China and



other countries have also proven to be unsafe at times—especially as the American-based dealers and distributors do not exert oversight responsibility. Some of the consumer laws and regulatory agencies that you may read about in the media and in the cases in this text include:

- Pure Food and Drug Act, 1906: Prohibits adulteration (ruining) and mislabels on food and drugs in interstate commerce.
- Federal Hazardous Substances Act, 1960: Controls labels on hazardous substances of products used in houses.
- Truth and Lending Act, 1960: Requires full disclosure of credit terms to buyers.
- Consumer Product Safety Act, 1972: Establishes safety standards and regulations of consumer products (created the Consumer Product Safety Commission (CPSC)).
- Fair Credit Billing Act, 1974: Requires accurate, current consumer credit reports.
- Telephone Consumer Protection Act, 1991: Issues procedures to avert undesired telephone solicitations.
- Children’s Online Privacy Protection Act, 1998: Requires the FTC to make rules to collect online information from children under 13 years old
- Do Not Call Implementation, 2003: Coordinates the FTC and FCC to provide consistence rules on telemarketing practices.

## Laws Protecting the Environment

Mercury from China, dust from Africa, smog from Mexico—all of it drifts freely across U.S. borders and contaminates the air millions of Americans breathe, according to recent research from Harvard University, the University of Washington and many other institutions where scientists are studying air pollution. There are no boundaries in the sky to stop such pollution, no Border Patrol agents to capture it.

The environment is seen less as an inexhaustible free source of clean air, water, soil, and food, and more a valued resource that requires protection—globally, regionally, and locally, as the quote above shows. As a sample of environmental laws below indicates, the environment constitutes sources of human, food, vegetation, and animal life.

- Clean Air Act, 1970: Designated air-quality standards; state implementation plans required for approval.
- National Environmental Act, 1970: Established policy goals for federal agencies; enacted the Council on Environmental Quality to monitor policies.
- Federal Water Pollution Control Act, 1972: Prevents, reduces, and eliminates water pollution.
- Endangered Species Act, 1973: Provides a conservation program for threatened and endangered plants and animals and their habitats.
- Noise Pollution Act, 1972: Controls noise emission of manufactured products.
- Safe Drinking Water Act, 1974: Protects the quality of drinking water in the U.S.; sets safety standards for water purity and requires owners and operators of public water to comply with standards.

- Toxic Substances Act, 1976: Requires testing of certain chemical substances; restricts use of certain substances.
- Food Quality Protection Act, 1996: Requires a new safety standard that must be applied to all pesticides used on foods: reasonable certainty of no harm.

Other laws regarding the environment, consumers, equity and discrimination are discussed in Chapter 7 of this text. Taken together, this sample of laws aimed at protecting stakeholders, the public, and the system in which business is conducted indicates the complexity of transactions, responsibilities, and number of stakeholders with which corporations do business. Business ethics and social responsibility can arguably be seen not as a luxury and/or dichotomy, but as a necessity in providing for and protecting the common good. This point should become even more evident in the concluding section of this chapter, which illustrates classic cases of corporate crises in which stakeholder relationships were not well managed.

## 4.5 MANAGING EXTERNAL ISSUES AND CRISES: LESSONS FROM THE PAST (BACK TO THE FUTURE?)

Companies have made serious mistakes as the result of poor self-regulation. As several of the now-classic environmental and product- and consumer-related crises illustrate, corporations have responded and reacted slowly and many times insensitively to customers and other stakeholders. The Internet may decrease the time executives have to respond to potential and actual crises.<sup>64</sup>

We conclude this chapter by reviewing some of the major crises from the 1970s to the present, since several of these are only now being resolved. These cases also serve to remind corporate leaders and the public that there is a balance between legal regulation and corporate self-regulation. When corporations fail to regulate themselves and to provide just and fair corrective actions to their failures, government assistance is needed.

We noted in Chapter 2 that issues and crisis management should be part of a company's management strategy and planning process. Failure to effectively anticipate and respond to serious issues that erupt into crises has been as damaging to companies as the crises. The Exxon Valdez oil spill and the Manville Corporation's asbestos crisis are summarized in the feature boxes on the following pages. The insightful reflections and lessons of Dennis Gioia, Ford's vehicle recall coordinator during the infamous Ford Pinto disaster, is a case included in this text. A sample of other crises includes the following:<sup>65</sup>

- In June 2001, Katsuhiko Kawasoe, Mitsubishi Motor Company's president, apologized for that firm's 20-year cover-up of consumer safety complaints. (The company also agreed in 1998 to pay \$34 million to settle 300 sexual harassment lawsuits filed by women in its Normal, Illinois plant. This is one of the largest sexual harassment settlements in U.S. history.)
- By the end of 2001, the American Home Products Corporation paid more than \$11.2 billion to settle about 50,000 consumer lawsuits related to the fen-phen diet drug combination. In addition, the company put aside \$1 billion to cover future medical checkups for former fen-phen users and \$2.35 billion to settle individual suits.

- Between 1971 and 1974, more than 5,000 product liability lawsuits were filed by women who had suffered severe gynecological damage from A. H. Robins Company's Dalkon Shield, an intrauterine contraceptive device. Although the company never recalled its product, it paid more than \$314 million to settle 8,300 lawsuits. It also established a \$1.75 billion trust to settle ongoing claims. The firm avoided its responsibility toward its customers by not considering a recall for nine years after the problem was known.
- Procter & Gamble's Rely tampon was pulled from the market in 1980 after 25 deaths were allegedly associated with toxic shock syndrome caused by tampon use.
- Firestone's problems first came to light in 1978, when the Center for Auto Safety said it had reports that Firestone's steel-belted radial TPC 500 tire was responsible for 15 deaths and 12 injuries. In October 1978, after attacking the publicity this product received, Firestone executives recalled 10 million of the 500-series tires. Firestone recently paid \$7.5 million in addition to \$350,000 to settle the first case in the Bridgestone/Firestone-Ford Explorer crisis. Two hundred injury and death suits have been settled since the recall, and it is estimated that it will cost \$50 million to settle the lawsuits.
- A federal bankruptcy judge approved Dow Corning Corporation's \$4.5 billion reorganization plan, with \$3.2 billion to be used to settle claims from recipients of the company's silicone gel breast implants and the other \$1.3 billion to be paid to its commercial creditors. A jury had already awarded \$7.3 million to one woman whose implant burst, causing her illness. The company is alleged to have rushed the product to market in 1975 without completing proper safety tests and to have misled plastic surgeons about the potential for silicone to leak out of the surgically implanted devices. More than 600,000 implants were subsequently performed.



## Johns-Manville Corporation: Asbestos Legacy

“They’ll be following in our footsteps,” said Robert A. Falise, chairman of the Manville Personal Injury Settlement Trust, which was created by the bankruptcy court to ensure a steady source of money to pay claims filed against Johns-Manville by workers exposed to asbestos in their workplaces.”<sup>1</sup> The company will be responding to outstanding claims by asbestos victims and their families for several decades. In June 2000, the

company was sold to Warren Buffett for \$1.9 billion in cash and the assumption of \$300 million in debt. The asbestos-related trust, created to pay claimants, received \$1.5 billion. As of March 2001, the trust had paid more than \$2.5 billion to 350,000 beneficiaries. There are still more than a half million claimants and another half million expected to file. Looking backward, reviews of Manville’s social responsibility management of the

complex web of issues surrounding its asbestos production are mixed.

Asbestosis, mesothelioma, and lung cancer—all life-threatening diseases—share a common cause: inhalation of microscopic particles of asbestos over an extended period of time. The link between these diseases and enough inhaled asbestos particles is a medical fact. Manville Corporation is a multinational mining and forest product manufacturer, and it was a leading commercial producer of asbestos. As of March 1977, 271 asbestos-related damages suits were filed against the firm by workers. The victims claimed the company did not warn them of the life-threatening dangers of asbestos. Since 1968, Manville has paid more than \$2.5 billion in such claims. And since the 1950s, Manville has faced hundreds of lawsuits from workers: Their estimated value is more than \$1 billion. By 1982, Manville faced more than 500 new asbestos lawsuits filed each month. Consequently, in August 1982, Manville filed for Chapter 11 bankruptcy in order to reorganize and remain solvent in the face of the lawsuits; the firm was losing more than half the cases that reached trial. The reorganization was approved, and Manville set up a \$2.5 billion trust fund to pay asbestos claimants. Shareholders surrendered half their value in stock, and it was agreed that projected earnings over 25 years would be reduced to support the trust.

Manville devised a settlement that gave the Manville Personal Injury Settlement Trust enough cash to continue meeting claims filed by asbestos victims. Under the settlement, the building products division stated it would give the trust 20% of Manville's stock

and would pay a special \$772 million dividend in exchange for the trust's releasing its right to receive 20% of Manville's profits. After the transaction, the trust would own 80% of Manville and have \$1.2 billion in cash and marketable securities, plus \$2.3 billion in assets. This transaction enabled Manville to rectify its balance sheet. Also, it changed its name to Schuller Corporation.

After Manville spent several years operating under Chapter 11 of the U.S. Bankruptcy Code, the company emerged with \$850 million in cash, 50% of its common stock, a claim on 20% of the company's consolidated profits, and bonds with a face value of \$1.3 billion. The trust is expected to pay 10% of an estimated \$18 billion in present and future asbestos claims to 275,000 victims who already have filed claims.<sup>2</sup>

The extent of Manville's social responsibility toward its workers, the litigants, the communities it serves, and society has, at best, been uneven. Manville, since 1972, has been active and cooperative with the U.S. Department of Labor and the AFL/CIO in developing standards to protect asbestos workers. However, Dr. Kenneth Smith—the medical director of one of the firm's plants in Canada—refused in the 1970s to inform Manville workers that they had asbestosis.

There is also the complication and confusion of evolving and changing legislation on asbestos. The U.S. Supreme Court, as stakeholder, has not taken a stand on who is liable in these situations: Are insurance firms liable when workers are initially exposed to asbestos and later develop cancer, or are they liable 20 years later? Also,

right-to-know laws are not definitive in state legislatures. Does that leave Manville and other corporations liable for government's legal indecision?

Of the original 16,500 personal injury plaintiffs, 2,000 have died since the reorganization in 1982. With Warren Buffet's purchase of the company and the asbestos trust solidified, the management of this issue for the company is over.

Note that companies continue to settle asbestos lawsuits. The *Mesothelioma Reporter* Web site (<http://www.mesotheliomareporter.org/lawsuits/>) tracks and reports these settlements. For example, a recent settlement was reported for Pfizer, subsidiary Quigley Co., and others who were defendants at a trial "that alleged that they caused personal injury by exposure to asbestos. The asbestos sometimes caused mesothelioma." That Web site reported that ABC News stated that "Pfizer will establish a trust for the payment of pending claims as well as any future claims. It will contribute \$405 million to the trust over 40 years through a note, and about \$100 million in insurance. Pfizer

will also forgive a \$30 million loan to Quigley."<sup>3</sup> As with other corporate crises, the aftermath continues.

### Notes

1. Gross, D. (April 29, 2001). Recovery lessons from an industrial phoenix. *New York Times*, 3, 4.
2. Tejada, C. (1996). Manville settlement gives trust enough cash for asbestos claims. *Wall Street Journal*.
3. Pfizer to pay \$430 million to settle asbestos claims. (September 3, 2004), *The Mesothelioma Reporter*.

### Questions

1. Should asbestos victims' claims be the liability of Manville or of the decision makers who authorized the work policies and orders?
2. Who was or is to blame for the asbestos-related deaths and injuries in the Manville case?
3. Is the declaration of Chapter 11 bankruptcy and the creation of a trust the best or only solution in this case? Who wins and who loses with this type of settlement? Why?
4. What ethical principle(s) did Manville's owners and officers use regarding this type of settlement? What principle(s) do you believe they should have used? Explain.

## Exxon Valdez: Worst Oil Spill in United States History: Victims' Compensation Still Not Awarded (June 2008)

"A year after the Exxon Valdez ripped open its bottom on Bligh Reef [off the Alaskan coast] and dumped 11 million gallons of crude oil, the nation's worst oil spill is not over.

Like major spills in the past, this unnatural disaster sparked a frenzy of reactions: congressional hearings, state and federal legislative proposals for new preventive measures,

dozens of studies, and innumerable lawsuits.”<sup>1</sup> The grounding of the tanker on March 24, 1989, spread oil over more than 700 miles. Oil covered 1,300 miles of coastline and killed 250,000 birds, 2,800 sea otters, 300 seals, 250 bald eagles, and billions of salmon and herring eggs, according to the Exxon Valdez Oil Spill Trustee Council, which manages Exxon settlement money.

As of June 23, 2008, the court case was still pending. More controversial is Exxon’s failure to pay the \$5 billion in assessed damages.<sup>2</sup> A grand jury indicted Exxon in February 1990. At that time, the firm faced fines totaling more than \$600 million if convicted on the felony counts. More than 150 lawsuits and 30,000 damage claims were reportedly filed against Exxon, and most had not been settled by July 1991, when Exxon made a secret agreement with seven Seattle fish processors. Under the arrangement, Exxon agreed to pay \$70 million to settle the processors’ oil-spill claims against Exxon. However, in return for the relatively quick settlement of those claims, the processors agreed to return to Exxon most of any punitive damages they might be awarded in later Exxon spill-related cases. Exxon paid about \$300 million in damages claims in the first few years after the spill. However, “lawyers for people who had been harmed called that a mere down payment on losses that averaged more than \$200,000 per fisherman from 1990 to 1994.”<sup>3</sup>

The charge that the captain of the Valdez, Joseph Hazelwood, had a blood-alcohol content above 0.04% was dropped, but he was convicted of negligently discharging oil and

ordered to pay \$50,000 as restitution to the state of Alaska and to serve 1,000 hours cleaning up the beaches over five years.<sup>4</sup> Exxon executives and stockholders have been embroiled with courts, environmental groups, the media, and public groups over the crisis. Exxon has paid \$300 million to date in nonpunitive damages to 10,000 commercial fishers, business owners, and native Alaskan villages.

In 1996, a grand jury ordered Exxon to pay \$5 billion in punitive damages to the victims of the 1989 oil spill. At the time that the fish processors had entered the secret agreement with Exxon, they did not know the Alaskan jury would slap the company with the \$5 billion punitive damages award. One of the judges claimed that had the jury known about this secret agreement, it would have charged Exxon even more punitive damages.<sup>5</sup> As of 2001, Exxon had not paid any of these damages. It is also estimated that with Exxon’s reported rate of return on its investments, it makes \$800 million every year on the \$5 billion it does not pay. (The company would have made back the \$5 billion it refused to pay with accrued interest by 2002.)<sup>6</sup> Brian O’Neill, the Minneapolis lawyer who represents 60,000 plaintiffs in the suit against Exxon, stated, “I have had thousands of clients that have gone bankrupt, got divorced, died, or been down on their financial luck” while waiting for the settlement.<sup>7</sup> Looking back on this case, Captain Hazelwood was ordered to pick up trash on Alaska state lands. The November 2001 federal appeals court ruling opened the way for a judge to reduce the

\$5 billion punitive verdict. (However, the 1994 jury award of \$287 million to compensate commercial fishers was not reduced.)<sup>8</sup>

In 2004, the Environmental News Network (ENN) reported that local residents and several government scientists are still at odds as to “whether Exxon Mobil Corporation should be forced to pay an additional civil penalty for the spill. . . . The landmark \$900 million civil settlement Exxon signed in 1991 to resolve federal and state environmental claims included a \$100 million re-opener clause for damages that ‘could not reasonably have been known’ or anticipated.”

### Epilogue

On June 25, 2008, the Supreme Court reduced the previously determined \$5 billion punitive damages award against Exxon Mobil to \$507.5 million.<sup>9</sup> Since Justice Samuel A. Alito, Jr. owns Exxon stock, he did not participate in the final decision. With regard to whether Exxon should be held accountable for Captain Hazelwood’s irresponsibility in the case, the court split 4-to-4. “The effect of the split was to leave intact the ruling of the lower court, the United States Court of Appeals for the Ninth Circuit, which said Exxon might be held responsible.”<sup>10</sup>

Justice David Souter hinted in his last paragraph on behalf of the 5-to-3 majority that this decision reflected the rule he was announcing for federal maritime cases in the Exxon case, “. . . a rule that generally dictates a maximum 1:1 ratio between a punitive damages award and a jury’s compensatory award. . . .”<sup>11</sup> In effect, by reducing the Exxon Valdez verdict to \$500 million, the

court set a 1:1 ratio by passing the \$507.5 million compensatory damage portion of the jury’s award in this case.<sup>12</sup> Stakeholders were divided in the outcome of this case. It should be noted that Exxon had previously paid over \$2 billion during the past 19 years on environmental cleanup and \$1.4 billion in fines and compensation to thousands of fishermen and cannery workers. Exxon Chairman and CEO Rex Tillerson recently stated that, “We have worked hard over many years to address the impacts of the spill and to prevent such accidents from happening in our company again.”<sup>13</sup> A different reaction came from the hard-hit Alaskan town of Cordova, where fishermen and local businesses suffered bankruptcies and even suicides in the long aftermath of the crises: “The punitive damages claim ‘was about punishing [Exxon] so they wouldn’t do it somewhere else,’ said Sylvia Lange, who owns a hotel and bar frequented by fishermen. ‘We were the mouse that roared, but we got squished.’”<sup>14</sup> As a result of the June 2008 Supreme Court decision, fishermen and others hurt by the Valdez disaster will receive about \$15,000 instead of \$75,000. Note that in 2007, ExxonMobil earned a record \$40.6 billion in profits. The company could pay the punitive award in four days’ profits.<sup>15</sup>

Hosmer, a noted ethicist, stated:

The most basic lesson in accident prevention that can be drawn from the wreck of the Exxon Valdez is that management is much more than just looking at revenues, costs, and profits. Management requires the imagination to understand the full mixture



of potential benefits and harms generated by the operations of the firm, the empathy to consider the full range of legitimate interests represented by the constituencies of the firm, and the courage to act when some of the harms are not certain and many of the constituencies are not powerful. The lack of imagination, empathy, and courage at the most senior levels of the company was the true cause of the wreck of the Exxon Valdez.<sup>16</sup>

### Notes

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2. Allen, S. (March 7, 1999). Deep problems 10 years after Exxon Valdez/Worst oil spill in US has lingering effects for Alaska, industries. *Wall Street Journal*, A1.
3. Ibid.
4. See the following Web site for resources regarding the aftermath and information on the Exxon Valdez crisis: <http://library.thinkquest.org/10867/research/online-sources.shtml>.
5. McCoy, C. (June 13, 1996). Exxon's secret Valdez deals anger judge. *Wall Street Journal*, A3.
6. Rawkins, R. (Feb. 28, 1990). U.S. indicts Exxon in oil spill. *Miami Herald*, 5.
7. See note 4 above.
8. Associated Press. Exxon Valdez fine excessive, court says. (Nov. 8, 2001). *USA Today*, 6A.
9. Liptak, A. (June 26, 2008). Damages cut against Exxon in Valdez case. *New York Times*, <http://www.nytimes.com/2008/06/26/washington/26punitive.html?ref=us>.
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12. Ibid.
13. Savage, D. (June 26, 2008). Punitive damages against Exxon in oil spill case slashed by 80%. *Los Angeles Times*, <http://www.latimes.com/news/nationworld/nation/la-na-valdez26-2008jun26,0,3673626.story>.
14. Ibid.
15. Ibid.
16. Hosmer, L. (1998). Lessons from the wreck of the Exxon Valdez: The need for imagination, empathy, and courage. *Business Ethics Quarterly*, 122.

### Questions

1. Who was at fault in this case and why?
2. Should Captain Hazelwood have been convicted of criminal drunkenness in this case? If so, how would that have changed the outcome of the settlement? If not, why?
3. Did Captain Hazelwood settle his "debt" in this case by agreeing to serve 1,000 hours in cleanup time in Alaska? Explain.
4. Describe Exxon's ethics toward this disaster based on what it has paid over the years up to the June 15, 2008 Supreme Court decision.
5. How much should the 33,000 commercial fishermen, Alaska Native peoples, landowners, businesses, and local governments have been paid as compensation, and why?
6. Respond to Hosmer's statement. Do you believe this sentiment applies to all responsibilities of senior executives in corporations; that is, do they need to show imagination, empathy, and courage toward all their constituencies? Explain your answer.



## CHAPTER SUMMARY

Managing corporate social responsibility from the corporate board of directors to the marketplace requires commitment, and significant time, effort, and resources from organizations. At stake is a company's reputation, and even survival. External regulation is also required to help define guidelines and practices for companies to act responsibly toward their stakeholders, communities, and society.

The corporation as social and economic stakeholder was presented from the perspectives of the social contract and covenantal ethic. Corporate social responsibility was also discussed from legal, ethical, philanthropic, and pragmatic views. Managing and balancing legal compliance with ethical motivation was illustrated by the Sarbanes-Oxley Act and the revised Federal Sentencing Guidelines for Organizations. A section on legal and regulatory laws and compliance was presented to show the complexity of areas in which corporations must navigate with federal, state, and local agencies before creating and distributing their products and services. A summary of events from corporate scandals was shown by explaining the need for legal compliance in corporations. Arguments were offered to explain that legal compliance legislation and programs alone are necessary but not sufficient to motivate ethical and legal behavior in organizations.

Corporate responsibility toward consumers was presented by explaining these corporate duties: (1) the duty to inform consumers truthfully, (2) the duty not to misrepresent or withhold information, (3) the duty not to unreasonably force consumer choice or take undue advantage of consumers through fear or stress, and (4) the duty to take "due care" to prevent any foreseeable injuries. The use of a utilitarian ethic was discussed to show the problems in holding corporations accountable for product risks and injuries beyond their control.

The free-market theory of Adam Smith was summarized by way of explaining the market context governing the exchange of producers and buyers. Several limits of the free market were offered—namely, imperfect markets exist, the power between buyers and sellers is not symmetrical, and the line between telling the truth and lying about products is very thin. Economist Paul Samuelson's "mixed-economy" was introduced to offer a more balanced view of free-market theory and of the unrealistic demands often placed on corporations in marketing new products.

An overview of two classic business ethics cases, Johns-Manville Corporation and Exxon Valdez, was presented to illustrate how legal, regulatory agencies are part of a much broader stakeholder system involving communities and groups in the marketplace. Laws and regulations, as mentioned earlier, are necessary but not sufficient forces with which corporate leaders must deal in order to act fairly toward their constituencies while being profitable.

## QUESTIONS

1. Identify a company or organization in the media or with which you are familiar that operates ethically. What are the reasons this company/organization is ethical? (You may refer to the leadership, management, products, or services of the organization.)

2. Do you believe that the Sarbanes-Oxley Act is *not* needed? Explain or offer a different argument.
3. Are the revised 2004 Federal Sentencing Guidelines, in your opinion, helpful to organizational leaders and boards of directors in promoting more ethical behavior? Explain. What other actions, policies, or procedures would you recommend?
4. Which of the corporate crises summarized at the end of the chapter were you unfamiliar with? Do you believe these crises represent business as usual or serious breakdowns in a company's system? Why?
5. After reading the Johns-Manville and Exxon Valdez summaries, identify some ways these crises could have been (1) avoided and (2) managed more responsibly after they occurred.
6. What was your score on the Rank Your Organization's Reputation quiz in the chapter? After reading previous chapters in this book, how would you describe the "ethics" of your organization, university, or college toward its customers and stakeholders? Explain.
7. Do you believe the covenantal ethic and social contract views are realistic with large organizations like ExxonMobil and Citibank or federal agencies like the FTC and the Department of Defense? Why or why not? Explain.
8. What is the free-market theory of corporate responsibility, and what are some of the problems associated with this view? Compare this view with the social contract and stakeholder perspectives of corporate social responsibility.
9. If you had to select either the legal/compliance ("stick") approach or the voluntary/ethical compliance ("carrot") approach toward running a corporation, which would you choose, and why? What would be likely consequences (positive and negative) of your choice? Explain.

## EXERCISES

1. In the opening case, how would you evaluate the corporate "ethics" of TJX before the security breach?
2. Outline some steps you would recommend for preventing future corporate scandals like Enron, based on this chapter.
3. If you were consulting with a large corporation's executive team and were asked to talk about how that team could think about a "social contract" including "stakeholder management" reasoning, what would you recommend? (Write down your advice.)
4. You have been invited as a student who has studied business ethics to present a case to a CEO, CFO, and ethics officer of a mid-size firm wanting to be Sarbanes-Oxley compliant. You have been asked to discuss and help them argue the pros and cons of implementing this law. Lay out your approach and arguments, and be ready to tell them what you would recommend they do and why.
5. A large company has invited you to join in a discussion with their legal and human resource officer about integrating ethics into and

between their departments. They want your ideas. Use Figure 4.2 and any other ideas from this (and previous chapters) to outline what you would contribute. (Write up a paragraph to share with your class/group.)

6. Find a recent article discussing an innovative way in which a corporation is helping the environment. Explain why the method is innovative, and whether you believe the method will actually help the environment or simply help the company promote its image as a good citizen. Use parts of this chapter to evaluate your answer.

**REAL-TIME ETHICAL DILEMMA**

My job requires that I lie every day I go to work. I work for a private investigation agency called XRT. Most of the work I do involves undercover operations, mobile surveillances, and groundwork searches to determine the whereabouts of manufacturers that produce counterfeit merchandise.

Each assignment I take requires some deception on my part. Recently I have become very conscious of the fact that I frequently have to lie to obtain concrete evidence for a client. I sometimes dig myself so deeply into a lie that I naturally take it to the next level without ever accomplishing the core purpose of the investigation.

Working for an investigative agency engages me in assignments that vary on a day-to-day basis. I choose to work for XRT because it is not a routine 9 to 5 desk job. But to continue working for the agency means I will constantly be developing new untruthful stories. And the longer I decide to stay at XRT, the more involved the assignments will be. To leave would probably force me into a job photocopying and filing paperwork once I graduate from college.

Recently I was given an assignment which I believed would lead me to entrap a subject to obtain evidence for a client. The subject had filed for disability on workers' compensation after being hit by a truck. Because the subject refused to partake in any strenuous activity because of

the accident, I was instructed to fake a flat tire and videotape the subject changing it for me. Although I did not feel comfortable engaging in this type of act, my supervisors assured me that it was ethical practice and not entrapment. Coworkers and other supervisors assured me that this was a standard "industry practice," that we would go out of business if we didn't "fudge" the facts once in a while. I was told, "Do you think every business does its work and makes profits in a purely ethical way? Get real. I don't know what they're teaching you in college, but this is the real world." It was either do the assignment or find myself on the street—in an economy with no jobs.

**Questions**

1. What is the dilemma here, or is there one?
2. What would you have done in the writer's situation? Explain.
3. React to the comment, "Do you think every business does its work and makes profits in a purely ethical way? Get real. I don't know what they're teaching you in college, but this is the real world." Do you agree or disagree? Why?
4. Describe the ethics of this company.
5. Compare and contrast your personal ethics with the company ethics revealed here.

## Case 11

### Reinventing Napster: How Many Lives for the Cat with Headphones?

Napster and other Internet companies opened the proverbial Pandora's box when they introduced peer-to-peer (P2P) networks. P2P applications changed the way people used the Internet by creating an environment where millions of users could share various types of files, including ones that hold a copyright, such as digital music files called MP3s (i.e., Motion Picture Engineering Group Audio Layer 3). Napster rapidly became one of the most popular P2P applications, amassing a file-sharing community with millions of registered accounts. "At its peak, in March 2001, Napster's servers were enabling users to copy more than 165 million music files per day. At least 87% of those files were copyrighted and therefore not theirs to copy."

Napster.com originally provided its services and interface programs to make the exchange of MP3s more straightforward and convenient. This convenience fomented a controversy over the legality of using music without permission from the owner. The Napster P2P application, in conjunction with the continuous improvement of Internet connectivity and speed, enabled users to have unrestricted access to music and to copy limitless files for free. "Napster was so terrifyingly efficient at connecting consumers with one another to 'share' their music that anyone with a computer could quickly find any song with a simple Web search. Music no longer was a physical product made of plastic; it was now an ethereal concept that could be stored on a hard drive and shared at will, broadcast to anyone with a few moments to do a Web search."

Napster and other companies impacted several groups in society, most notably the music industry. Dr. Dre, a concerned music artist, summed up his feelings toward Napster this way: "I'm in the business to make money, and Napster is \_\_\_\_\_ing that up!" Both popular artists and lesser known songwriters and composers rely upon music sales for their livelihoods, and they were affected negatively by the file-sharing technology.

The corporations that provided financial and marketing support to recording artists and songwriters were also affected by file-sharing technology. Warner Brothers Music, Sony, Bertelsmann Music Group (BMG), Universal, and EMI Group, all members of the Recording Industry Association of America (RIAA), settled lawsuits with MP3.com for distributing copyrighted materials without their consent over the Internet. The suits were targeted toward protecting the rights of copyright owners and recording artists to be compensated for their works. According to Ethan Smith, a reporter for the *Wall Street Journal*, the violation of the rights of artists and copyright owners through digital-music piracy "allowed many would-be music buyers to fill their CD racks or digital-music players without ever venturing into a store."

After the settlement with MP3.com, the focus was no longer on who would distribute the music over the Internet, but rather how. The same plaintiffs who filed lawsuits against MP3.com also filed lawsuits against Napster, claiming that the company's music-sharing application encouraged copyright infringement by facilitating the exchange of songs over the Internet for free. Napster users had a much different view of freely exchanging MP3 files over the Internet. Market

**Napster's Fall from Glory** The file-sharing technology developed by

research indicated that young people who traded MP3 files “had significantly different values than their elders when it came to the legality and morality of downloading. Appeals to younger consumers by the RIAA to equate the trading of MP3s with shoplifting fell flat.”

In its legal battles, Napster had both its supporters and detractors. Limp Bizkit was one of the first musical groups to adopt Napster and its file-sharing service. The band’s lead singer, Fred Durst, publicly supported Napster, saying the file-sharing service both provided an amazing way to market music to a mass audience and a great opportunity for fans to sample an album before buying it. Courtney Love, another recording artist, was a Napster supporter. Artists opposing Napster included Elton John, Puff Daddy, Dr. Dre, and Metallica. Both Dr. Dre and Metallica sued Napster for copyright infringement.

By mid-2001, Napster lost its court battles with the music industry, and Napster’s free music file-sharing service was shut down.

**Reinventing Napster** Napster’s name, some intellectual property, and hardware were sold at auction to Roxio Inc., a software company that developed and sold CD-burning applications. Roxio later sold its consumer software division and renamed itself Napster Inc. in 2004.

The reinvented Napster focused its online music sales on single-song purchases as well as subscriptions for unlimited access to its music list. Registered Napster members could “listen to any track in its catalog up to three times for free.” They could “then purchase the tracks à la carte for 99¢, or become a Napster To Go subscriber for \$14.95 a month and listen as often as they like.” However, if Napster subscribers stopped paying their monthly fees, they no longer had access to the music they had purchased.

To protect their financial interests, the major record labels required online music stores like Napster “to sell files saddled with digital rights management (DRM), the industry’s euphemism for

encryption designed to limit copying.” However, because of the embedded DRM technology, any Napster To Go customer who decided to try out the service and then discontinue it couldn’t play any of the music that he or she had already purchased.

**Reinventing Napster Again** Subsequent to its commercial reinvention as a seller of digital music on either a single-song or subscription basis, Napster has reinvented itself again. The first change was the use of advertising to give customers a limited opportunity to listen to songs in the Napster music catalog for free. The second change was to enter into mobile music partnerships, and the third was to convert all the music in the Napster catalog to MP3 files so the music could be played on any portable music player.

**Limited Free Napster—Supported by Advertising** In May 2006, Napster began offering an advertising-supported free version of its subscription service; the free version permitted “consumers to listen to as many as five tracks free while they view advertising.” However, users could only listen to a song three times a month, and couldn’t load the songs onto a portable player or copy them. The goal of the free service, according to Laura Goldberg, Napster’s Chief Operating Officer, was to convert users into paid subscribers. Napster’s free version attracts four million unique visitors each month. Napster hasn’t disclosed how many users of the free service have converted to paid subscribers—which numbered at 518,000 in November 2006.

**Mobile Music** In November 2007, AT&T announced that it was “making Napster Inc.’s entire music catalog of more than five million songs available for purchase and wireless downloading.” Songs would cost \$1.99 each, or \$7.49 for five per month. Users who downloaded a song directly to their phones would automatically get an e-mail allowing them to put a second copy on their computers. Customers who had songs through

Napster could also transfer them to their phones. Although Napster had similar though smaller deals with other companies in the United States and overseas, this new arrangement with AT&T created an enormous U.S. customer base for Napster. Brad Duda, Napster's president, held that the new arrangement with AT&T would enable Napster to compete more directly with Apple's iTunes.

### **MP3 Files for Music Player Flexibility**

In an August 2007 article in *Kiplinger's Personal Finance*, Phil Leigh, president of the market-research firm Inside Digital Media, was reported as saying that unrestricted music is on the horizon. Leigh predicted "wholesale DRM-free downloads within a year or two" because "[m]ainstream consumers will not pay to complicate their lives." Just a few months later, in early January 2008, Napster announced that it would begin selling "all its downloads without the software that limits how buyers can use them." Downloads would be sold in the MP3 format that lacks digital-rights-management (DRM) software. "Previously, songs sold by Napster came with DRM software that let them be played only on devices that use Microsoft Corp.'s Windows Media DRM. The shift doesn't affect Napster's subscription music service, which will continue to work only with a handful of specialized devices. The new format also would enable file sharing." The primary advantage of MP3 files for both consumers and Napster "is that they can be played on virtually any digital music player, including Apple Inc.'s market-dominating iPod."

Although the shift to MP3 files was scheduled to take place between April and June 2008, Napster was still working developing or finalizing agreements with four major music companies—Sony BMG Music Entertainment, Warner Music Group, EMI Group, and Universal Music Group—as 2008 began. All but Sony BMG Music Entertainment had already begun selling MP3s on Amazon.com's new download service. By mid-year 2008, the agreements had been

consummated, and Napster was touting its MP3 catalog as the world's largest, with over 6 million songs. According to Chris Gorog, Napster's chairman and chief executive officer, even though the move to MP3s is expected to boost the company's download sales, the move has a much greater significance in its potential "to break down the dominance of the closed iPod-iTunes system."

### **Beyond the Current Incarnation of Napster**

Producers in the music industry appear to be caught in a conundrum in their approach to digital music. In past years, Sony BMG Music Entertainment, Warner Music Group, EMI Group, and Universal Music Group have gone overboard in their resistance to digital music. On the other hand, "The music industry has been banking on the rise of digital music to compensate for inevitable drops in sales of CDs. . . . It hasn't worked out that way—at least so far. Overall, sales of all music—digital and physical—are down. . . . Meanwhile, one billion songs a month are traded on illegal file-sharing networks, according to BigChampagne LLC."

As CD sales continue to decline at a massive pace, the music industry has reached a crisis point; and "that's creating a good-news story for the digital space, because [the labels] have to make these other things work." Now the major music labels "are slowly becoming more open to experimenting digitally because they don't have a choice, experts say, meaning a host of innovative new music services have a future." "Record labels have no choice but to invest in digital music. But the industry still has a ways to go to win over today's music fans, especially the younger ones. Few of the new innovative services are iPod-compatible, and digital-rights management software, which limits where and how songs can be played, still factors into most [digital music]—not the best way to reach consumers raised on illegal downloading."

How will this shift toward embracing digital music affect the future of

Napster? One cannot help but wonder if another reinvention of Napster is in the offing. Coupling previous incarnations of Napster—with its logo of a cat wearing earphones—brings to mind the adage of “a cat having nine lives”! Indeed, how many lives does Napster have?

### Questions for Discussion

1. Do you think that it is unethical for someone to download copyrighted music without paying for it?
2. Who are the key stakeholders, and how have they changed since Napster’s beginning?
3. What were the stakes for the different constituencies associated with Napster’s first, second, and third incarnations?
4. Given that Napster has reinvented itself twice in its short organizational life, what do you think the future holds?

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## Case 12

### VIOXX, Dodge Ball: Did Merck Try to Avoid the Truth?

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**Overview** On September 30, 2004, Merck & Company ("Merck") voluntarily withdrew VIOXX (rofecoxib), its blockbuster arthritis drug that had been on the market since 1999. Since 2001, Merck had been facing accusations that VIOXX increased the risk of heart attack and stroke for those patients taking the drug for longer than 18 months. In a press release announcing the voluntary, worldwide withdrawal, Merck executives felt that although Merck could continue marketing the drug with new labels that incorporated the results of recent trials, the responsible action was to remove the product from the market. Since the withdrawal, thousands of lawsuits have been brought against Merck, and several questions remain, most notably: Did Merck suppress data early on, and will Merck be able to withstand the thousands of lawsuits that will take place in the coming years?

**The Beginning** Millions of Americans suffer from arthritis pains, with levels of pain that vary from minor to severe. Arthritis is a general term that means "joint inflammation," and there are more than 100 different types of rheumatic conditions and diseases that can cause joint inflammation. Different types of non-steroidal anti-inflammatory drugs ("NSAIDs") can be taken, ranging from ibuprofen to naproxen. The Cox-2 inhibitors were new drugs that were developed to block the Cox-2 enzyme, which is responsible for sending chemicals within the body that cause pain and inflammation. Merck and Pfizer, two of the largest pharmaceutical companies in the world, burst onto the scene in 1999 with their Cox-2 inhibiting drugs, VIOXX and Celebrex. Buoyed by the emerging trend of direct-to-consumer ("DTC") marketing, these companies began a marketing blitz targeting the general public.

In 2001, the National Institute for Health Care Management Research

and Educational Foundation released a report on the growing DTC trend. The report showed that in 2000, Merck spent \$160 million to advertise VIOXX, as compared to PepsiCo's \$125 million to advertise Pepsi, Budweiser's \$146 million to advertise its beer, and Pfizer's \$78 million to advertise Celebrex. This caused Merck's sales of VIOXX to increase 360% from 1999 to 2000, while Pfizer's sales of Celebrex increased 58% in that same period. Before the drug was approved, Merck had followed industry standard testing procedures. In 1998 however, an internal trial, study "090," revealed a higher number of cardiovascular problems in patients taking the drug, compared to those not taking VIOXX. The study showed that patients taking VIOXX were six times more likely to have a cardiovascular event than those taking a different arthritis drug or placebo. Merck felt that this test was too small (978 patients), and not statistically significant. Merck received approval from the FDA in 1999 to begin selling the drug, just behind Pfizer's release of Celebrex.

**Merck's Studies** In 1999, Merck launched another study on VIOXX, entitled VIGOR. The VIGOR study was the VIOXX Gastrointestinal Outcomes Research Study, and included 8,000 patients. The purpose of this study was to determine if VIOXX was any less damaging on the stomach than naproxen. NSAIDs, such as naproxen, have side effects that often include gastrointestinal problems and can cause abdominal pain, heartburn, and/or diarrhea. Of the 33 million Americans taking NSAIDs, between 10 and 50% develop these side effects; many so severely that they must stop taking NSAIDs due to stomach ulcerations. The Cox-1 enzyme produces mucus that protects the stomach lining, and many NSAIDs, such as naproxen, block both the Cox-1 and the Cox-2 enzymes. The benefit of

these new Cox-2 inhibiting drugs was that the Cox-1 enzyme was not blocked, and could thus continue to protect the stomach lining.

The results of this test proved that VIOXX did produce significantly less upper gastrointestinal events than naproxen. However, the tests revealed additional information: Patients taking VIOXX for more than 18 months were five times more likely to suffer a heart attack than those who took naproxen. At the time, Merck executives stated that this finding was due to naproxen's ability to protect the heart, not due to any specific issue with VIOXX. These results were published in the *New England Journal of Medicine* in 2000. At that time, many industry experts began to doubt the safety of VIOXX based on the results of the VIGOR study and the "090" study. Despite the results of these studies, Merck continued its advertising in 2000 and 2001. Between 1999 and 2003, Merck generated approximately \$2.3 billion in sales. In 2001, the FDA recommended that Merck include warnings on VIOXX labels, and also took issue with a misleading promotional campaign.

In a letter to Raymond Gilmartin, the president and CEO of Merck, Thomas Abrams, a director in the division of drug marketing, advertising, and communications, warned Merck that it had made false statements, used unsubstantiated claims, omitted risk information, and used audio conferences to promote VIOXX for unapproved usages and unapproved dosage. Note that "Abrams has been on all sides of drug marketing, from receiving promotions as a pharmacist to creating promotions as a member of industry to regulating promotions as the head of DDMAC. As such, he's in good position to see the big picture." The following is an excerpt from the letter:

You have engaged in a promotional campaign for VIOXX that minimizes the potentially serious cardiovascular findings that were observed in the VIOXX Gastrointestinal Outcomes Research (VIGOR) study,

and thus, misrepresents the safety profile for VIOXX. Specifically, your promotional campaign discounts the fact that in the VIGOR study, patients on VIOXX were observed to have a four- to five-fold increase in myocardial infarctions (MIs) compared to patients on the comparator non-steroidal anti-inflammatory drug (NSAID), Naprosyn (naproxen).

In 2002, Merck added language to the VIOXX label that disclosed the cardiovascular risks that were associated with VIOXX. Despite these warnings and the studies, VIOXX accounted for \$2.5 billion in sales in 2003 alone, with more than 91 million VIOXX prescriptions written throughout the history of the drug.

In 2000, Merck began a different study, this time to determine if VIOXX could successfully prevent the recurrence of colon polyps. This study was called APPROVe: the Adenomatous Polyp Prevention on VIOXX trial. The results of this trial echoed the results of the prior trials. Of the more than 2,600 patients that took part in the trial, those patients taking VIOXX for more than 18 months found themselves at a higher risk for cardiovascular events than those on a placebo. Specifically, the VIOXX patients were twice as likely to suffer an event as those not taking VIOXX. It was with this information that Merck decided to pull the drug in 2004.

**Dodge Ball VIOXX** While Merck was busy conducting internal studies, the sales force was being trained to handle the increasing amount of questions regarding the risks of cardiovascular events. When salespersons called on physicians, the questions of the risks were more frequent, such as, "I am concerned about the cardiovascular effects of VIOXX" and "I use Celebrex. I'm concerned with the safety profile with VIOXX." The name of this document was "Dodge Ball VIOXX." The 46-page document described the activities used to train the sales force, and included *Jeopardy!*-like question-and-answer sections to help the VIOXX

reps learn how to correctly answer or deflect physicians' questions. A 12-page list of categories was presented to the sales force, but many representatives were very concerned with the process. In a 2004 interview with *60 Minutes*, a rep who did not wish to be named said, "We were supposed to tell the physician that VIOXX did not cause cardiovascular events; that instead, in the studies, Naproxen has aspirin-like characteristics which made Naproxen a heart-protecting type of drug where VIOXX did not have that heart-protecting side." The rep added, "I put my reputation on the line. I gave my physicians my word that VIOXX was a safe, effective product and it's been pulled from the market because it was killing people." The final page of this 46-page training document highlighted the five top messages for VIOXX in 2000, and, in the last paragraph, stated, "This document must not be copied, distributed, or shown to anyone outside the company." This training document was one of the areas the FDA commented on when it notified Merck that it was engaging in promotional campaigns attempting to minimize the risks associated with VIOXX.

### Outside Opinions and Studies

When the internal Merck studies, "090" and VIGOR, were released, many in the medical community were concerned with the results, especially considering that VIOXX was a potential blockbuster drug that could be used by more than one hundred million worldwide. One such critic was Dr. Eric Topol, who was the chief of cardiovascular medicine at the Cleveland Clinic. Topol first began questioning the studies and Merck's responses in 2001. On October 21, 2004, Topol published an article in the *New England Journal of Medicine* in which he outlined the case against Merck and the FDA. As he recounted the results of the "090," VIGOR, and APPROVe studies, he noted that "Only by happenstance, in a trial involving 2600 patients with colon polyps who could not have been enrolled if they had had any cardiovascular

disease" was it discovered that there was an increased risk of cardiovascular events. Topol felt that neither Merck, nor the FDA, had fulfilled their responsibilities to the public based on the risks that were seen in the earlier studies. His own research of Cox-2 inhibitors and other medicines available showed a "very substantial worrying risk of heart attacks and strokes." He added, "So if you have Study '090,' and you want to discount that somehow, then you have VIGOR. You've got two trials now. You have essentially lightning striking twice. That's independent replication. That's really serious confirmation. This is unequivocal. This is a problem." Merck researchers responded to Dr. Topol's "Perspective" article with their own "Correspondence." In this correspondence, the researchers stated that Topol's timeline was false, and that other studies conducted by Merck did not show any increased risks in cardiovascular events versus placebo.

A common trend in the industry is that doctors consult for financial firms. A December 2004 edition of *Fortune* magazine identified a potential conflict of interest for Topol. He was on the scientific advisory board of a hedge fund, the Biomedical Value fund, run by Great Point Partners. This fund, with more than \$170 million in assets, performed very well in 2004, and much of this was due to the firms "shorting" of Merck. Selling "short" is a term used to describe when an investor is looking to profit from a stock's falling price. In a performance summary published in September 2004, Great Point Partners singled out Topol for his contribution to the increased earnings. "VIOXX, while good for your arthritis, can be very bad for your heart. Eric Topol, M.D., of our Medical Advisory Board, has been singing this tune since 2002, and we were on the right side [short] of that situation." When *Fortune* confronted Topol with this information, he immediately resigned from the board. Since this time, Merck lawyers have introduced this information to build the case that Topol has a personal "vendetta"

against Merck. In late 2005, Topol was demoted at the Cleveland Clinic. In February 2006, Topol announced that he would be leaving the clinic to teach at a nearby medical school.

### **The Recall and Initial Lawsuits**

On September 30, 2004, Merck voluntarily withdrew VIOXX from the market after the results of the APPROVe trial. Merck had made it clear that this was a voluntary recall, and that it was due to the heightened risk of cardiovascular events. Merck's CEO and president, Raymond Gilmartin, maintained that Merck could have relabeled the packaging to include warnings about the cardiovascular risks, but concluded that the voluntary withdrawal was the "responsible" action to take. But the already skeptical medical community was aware of the "090" and VIGOR studies. One month later, a study conducted by the FDA using information from approximately 1.4 million patients in the Kaiser Permanente healthcare organization found that the use of VIOXX more than tripled the patient's risk of cardiovascular event. Based on the number of VIOXX prescriptions written between 1999 and 2003, the study estimated that VIOXX may have contributed to more than 27,785 heart attacks or sudden cardiac arrests. This was initially published by the *Wall Street Journal*, but the results were never published by the FDA.

After the recall, word of the studies, and their results, began reaching the public. The legal system became flooded with activity. On August 19, 2005, the first lawsuit against Merck reached its conclusion in a Texas courtroom. Carol Ernst sued Merck, claiming that her husband Robert died in 2001 of an irregular heartbeat caused by VIOXX. Ernst's lawyer argued that Merck continued with an aggressive marketing campaign for VIOXX even though it was aware of the increased risk of a cardiovascular event for patients taking VIOXX. The jury agreed with Ernst, and awarded \$229 million in punitive damages and \$24.4 million in compensatory

damages. Texas law sets a cap on punitive damages, however, and analysts believe that they may be reduced to \$1.6 million. Merck maintains that they will fight the results of this decision.

As of January 31, 2006, Merck faced 9,650 VIOXX-related lawsuits. In 2004, Merck set aside \$675 million to use for legal fees in defending itself in the VIOXX lawsuits. In 2005, Merck used \$285 million, and was forced to replenish this reserve with another \$295 million, bringing the total to \$685 million for legal fees alone. Merck has yet to pay any damages, including the \$253 million awarded to Carol Ernst in 2005. However, Merck is prepared to fight each lawsuit separately and not push for a class-action lawsuit. In the three lawsuits previously filed against the company, Merck lost one case, won one case, and had a mistrial declared in the third. Jury selection for a retrial of the mistrial began on February 6, 2006, and a fourth case was underway in Texas for the heart attack death of a 71-year-old man.

### **VIOXX and Merck: Update**

Merck's official Web site announces that "The meeting of the thresholds with enrollment documents in compliance with the Settlement Agreement would obligate Merck to pay \$4.85 billion in installments into the resolution fund. In 2007, the Company recorded a pretax charge of \$4.85 billion, which represents the fixed amount to be paid by the Company to settle qualifying claims.

The thresholds are: (a) 85% or more of all eligible MI claims; (b) 85% or more of all eligible IS claims; (c) 85% or more of all eligible claims claiming death as an injury; and (d) 85% or more of all eligible claims alleging more than 12 months of use."

As of March 31, 2008 the claims administrator reports more than 28,250 eligible MI claimants have initiated enrollment and more than 16,750 eligible IS claimants have initiated enrollment. Of these, more than 5,500 eligible MI and IS claimants alleging death as an injury have initiated enrollment, and more

than 27,500 eligible MI and IS claimants alleging more than 12 months of use have initiated enrollment. Each of these numbers appears to represent at least 94.5% of the eligible claims in each category. These numbers do not include an additional 5,500 enrollees whose eligibility has yet to be determined.

**Looking Back to See Ahead** The Settlement “Merck&Co(MRK.N: Quote, Profile, Research) said on Thursday [July 17, 2008] that more than 97% of eligible U.S. claimants had elected to participate in its \$4.85 billion proposed Vioxx settlement, an adequate number to trigger funding of the program.

“The company expects that the distribution of interim payments to qualified claimants will begin in August and will continue on a rolling basis until all claimants who qualify for an interim payment are paid,” Merck said in a news release.” A Merck spokesperson said on July 17, 2008 that over 48,500 of approximately 50,000 people registered as eligible injuries had enrolled in the program.

With the increase scrutiny on corporate social responsibility, and the serious consequences that can arise if a pharmaceutical company is accused of violating public trust, companies such as Merck have been doing business on a slippery slope. Industry analysts reported after Vioxx’s settlement that “... the FDA has become far more careful about approving new medicines in the wake of the Vioxx withdrawal and criticism of the agency’s oversight of the medicine.”

Pharmaceutical companies have created many lifesaving drugs over the years, and have helped hundreds of millions of people. However, if a company is perceived to act unethically and violates the public trust, that company stands to face not only more lawsuits, but the loss of customers and the financial resources that help these companies succeed. Will this settlement be the last for Merck? Or, is this just another cost of doing business for the pharmaceutical giant operating in a

highly profitable and uncertain industry sector?

### Questions for Discussion

1. What were the first warning signals that VIOXX may have been unsafe for patients?
2. Who was responsible in this case for stopping the harm that occurred from the VIOXX drug, and at what point could the harm have been prevented? Explain.
3. Summarize Dr. Topol’s ethics as demonstrated in this case. What were his motives here?
4. What role did the sales force representatives play in this case?
5. Who ultimately is to blame in this case for the harm caused by VIOXX?
6. Should Merck be singled out as a major culprit in this case or is this “business as usual” for pharmaceutical companies? Would you expect Merck to be back on the top 100 Best Corporate Citizens and Companies list in a few years? Explain.

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## Case 13

### “Who Killed the Electric Car?”

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Note: “Who Killed the Electric Car?” is the title of a 2006 documentary film by Chris Paine who explored the start of America’s first battery powered electric vehicles. The film focused on the EV1 model created by General Motors in the 1990s. The film discusses reasons why and how the EV1 was taken off the market because of several stakeholders’ interests: e.g. the oil industry, government, automobile manufacturers.

**In the Beginning...General Motors** General Motors, one of the largest automakers in the world, has been the auto industry leader in sales for the past 76 years. In 2007, GM for the first time in its history tied with Toyota in global sales. GM also moved from 5th place in 2006 to 9th place in 2007 in Fortune’s annual ranking of the ‘World’s Largest Corporations.’ The company still employs 266,000 individuals and sells about nine million vehicles globally each year making the company a major contributor to the global economy. During 2007, it was the first automaker to sell 1 million vehicles in China; its sales also increased 74% in India. The company also is committed to selling in the emerging markets. Although based in Detroit, Michigan, GM segments its company into four regional divisions: GM North America, GM Europe, GM Latin America/Africa/Mid-East, and GM Asia Pacific. The company manufactures vehicles in 33 countries and has 7,350 dealers in the United States, 750 in Canada, 300 in Mexico, and approximately 15,600 overseas.

**Environmental Initiatives** Founded in 1908, GM has witnessed a significant change in the environmental standards set by society. To address these standards, GM adopted six environmental principles in 1991 “to serve as a guide

for all GM employees worldwide, encouraging environmental consciousness in both daily conduct and in the planning of future products and programs.” In the six principles, GM states that:

1. We are committed to actions to restore and preserve the environment.
2. We are committed to reducing waste and pollutants, conserving resources, and recycling materials at every stage of the product life cycle.
3. We will continue to participate actively in educating the public regarding environmental conservation.
4. We will continue to pursue vigorously the development and implementation of technologies for minimizing pollutant emissions.
5. We will continue to work with all governmental entities for the development of technically sound and financially responsible environmental laws and regulations.
6. We will continually assess the impact of our plants and products on the environment and the communities in which we live and operate with a goal of continuous improvement.

More specifically, Beth Lowery, vice president of Environment and Energy, identifies several areas GM focuses on with regard to these environmental initiatives. First, GM is determined to use innovative technologies to improve the environmental performance of its facilities. In addition, it is actively focusing on future fuel sources, such as hydrogen, while increasing production of hybrid electric vehicles. Finally, GM will continue to build better internal combustion engines, as these are its hallmark products.

Each year, GM publishes a *Corporate Responsibility Report* addressing



successes and challenges in its economic, environmental, and social performance. General Motors was awarded the inaugural EARTH ANGEL Award in 2008 as the most environmentally-friendly automaker making the most strides toward addressing global climate change and environmental issues. This award is based on a group of respected automotive journalists from different automotive publications. In 2005, GM accomplished many of its environmental goals. The GM North American region reduced CO<sub>2</sub> levels by 17.1% from 2000 to 2004, and 2.9% since 2003 alone. This decline can be directly related to the goals established by the U.S. Environmental Protection Agency's "Climate Leaders Program," which GM joined in 2001. This voluntary program urged its members to reduce CO<sub>2</sub> emissions by 10% from 2000 to 2005. GM accomplished this goal two years early. During 2005, GM set new targets within this program to ensure that it retained its leadership. Additionally, in 2004 GM met its goal of reducing energy consumption in its North American Operations by 25%, again one year ahead of schedule. It had already reduced energy consumption by 26.6% over the prior nine years.

**The Life of the EV1** General Motors addressed environmental concerns about its internal combustion engines by developing an electric vehicle that produced zero greenhouse gases. This approach was considered seriously for the first time in the late 1980s, but the concept of an electric car dates back over 150 years.

The story of the electric car begins in the 1830s. Robert Anderson, a Scotsman, invented the first electric carriage. At about the same time, Thomas Davenport built a small electric locomotive, which is considered to have been the first practical electrical vehicle. In 1891, an electric car was first built in the United States by William Morrison. This achievement would stimulate several years of success for electric car

development. In 1897, electric taxis were being used in New York City, and in 1899, Thomas Edison, one of the greatest inventors in history, announced his goal of creating a battery for commercial automobiles. In 1900, "the electric automobile [was] in its heyday. Of the 4,192 cars produced in the United States, 28% [were] powered by electricity, and electric autos represented about one-third of all cars found on the roads of New York City, Boston, and Chicago." This early success came to a crashing halt when Henry Ford revolutionized automobile production.

In 1908, Henry Ford introduced the first mass-produced, gasoline-powered automobile. Four years later gasoline-powered vehicles overcame another hurdle when Charles Kettering invented the electric starter, replacing the hand crank. These and other advances signaled the beginning of the end for the electric car. In the following years, gasoline-powered automobiles continued to improve and develop. Not until 1966 did a new discussion of the electric car begin, when Congress passed bills recommending its use. Once again, there was optimism about the electric car. A Gallup poll in 2006 showed 33 million Americans were interested in them. However, this boom deflated in subsequent years when a series of pro-gasoline events occurred.

In 1986, events led to the development of the modern electric car: General Motor's EV1. The first solar car race—which took place in Australia in 1983—served as a catalyst for the EV1. Roger Smith, the CEO of GM, was intrigued by an invitation to participate in this race and immediately approved funding to produce the vehicle. In November 1987, GM produced the Sunraycer and won the race handily. With this tremendous success, Howard Wilson, a vice president of GM, envisioned using similar technology for an electric car, and by 1990, a model was created. It was first showcased at an auto show in Los Angeles. Because of its great popularity, the California Air Resources Board (CARB) passed the Zero Emissions

Vehicle (ZEV) Mandate for the State of California, which “require[d] two percent of the state’s vehicles to have no emissions by 1998 and 10 percent by 2003.” In subsequent years, other car manufacturers began production of electric cars, with GM leasing its first EV1s to consumers in 1996. Just as before, this bright future for the electric car was quickly doused. In 2003, General Motors announced that it would not renew the leases for its EV1s because it could “no longer supply parts to repair the vehicles.” This officially killed the electric car.

GM’s announcement caused significant controversy, as many EV1 owners loved their new cars and couldn’t understand GM’s recall. GM gave two primary reasons: First, the EV1 could not be commercially successful because only 800 had been leased over a four-year period. Furthermore, of the 5,000 people on the EV1 waiting list, only 50 had agreed to sign a lease. (This argument is supported by the fact that no other auto manufacturer is producing an electric car currently.) GM’s second reason for recalling the EV1 was that parts suppliers quit making replacement parts, which meant that GM could not guarantee that the EV1 could be operated safely or repaired.

Some individuals questioned GM’s commitment to the EV1. However, it is important to recognize that GM spent over \$1 billion on marketing the EV1. Moreover, GM does not consider the development of the EV1 a failure since much of its technology is being used in GM’s new hybrid vehicles. The company sees the EV1 as a necessary first step to future greatness, and it looks forward to developing future fuel sources that will also help better the environment.

**Future Fuel Sources** Another possible reason for GM’s decision has to do with scientific advances in hydrogen fuel cell technology. These fuel cells create electrical energy when hydrogen and oxygen combine. As the electric car became available to consumers in 1996, this fuel cell technology also began to

blossom. In fact, GM introduced the Opel Zafira minivan, the first drivable fuel cell concept, at the Paris Motor Show in 1998. Fuel cell technology continued to develop as GM produced improved cars each year, and explored new partnerships and agreements to further the technology. One recent milestone has been the opening of a retail hydrogen fueling station in Washington, D.C., in 2004, a significant stride for hydrogen.

GM believes fuel cell technology will soon change our everyday lives as it will power not only our vehicles, but also our homes and office buildings. It will resolve the energy shortages the U.S. economy faces as well as minimize U.S. dependence on foreign oil. However, to achieve these results, several challenges must be addressed. First and foremost, our energy infrastructure, which is based entirely on oil, must be reformed. This will not occur overnight. In addition, the storage and cost of fuel cell technology must be considered. Consumers will expect hydrogen vehicles to operate as efficiently as modern gasoline-powered vehicles. If they do not, demand will decline drastically as it did with the electric car. In addition, current fuel cell technology is quite expensive. GM is confident that this can be reduced in time as well.

General Motors is also investigating E85 ethanol as a fuel source. This is a fuel blend of 85% ethanol and 15% gasoline. This new fuel source has several advantages. First, ethanol is produced from corn and other grain products so it is a renewable fuel source. Second, it provides more horsepower and torque than pure gasoline. Finally, it “burns cleaner than gasoline and helps to reduce smog-forming emissions and greenhouse gases.” GM has been working with this alternative fuel source since 1999, and is now the industry leader, with 1.5 million Flex-Fuel vehicles on the road. In addition, there are about 600 E85 fueling stations already established in the United States. Although this new source does not completely eliminate greenhouse

gases, it significantly reduces the amount produced—which is a step in the right direction.

Another alternative to gasoline-powered vehicles are hybrid vehicles, which serve as the bridge between the internal combustion engine and electric cars. In hybrids, “the engine charges the electric motor’s batteries and their load is then reduced by the motors. This allows the engine to run more efficiently using less fuel and producing fewer emissions.” Although this technique does not completely eliminate greenhouse gases, GM feels it is the best option available until long-term solutions, such as hydrogen or ethanol, are available. Since this is considered a short-term solution, GM decided to focus its production on vehicles with the lowest fuel efficiency, such as buses, trucks, and SUVs. In 2003, GM produced its first hybrid vehicle, a transit bus. Currently, over 25 U.S. cities have hybrid buses, and there are plans to deliver buses globally by the end of the decade. Hybrid trucks and SUVs have also been produced according to plan. Alternative fuel sources exist, but their success will be directly dependent on how GM and other car manufacturers promote and use them. If manufacturers produce these vehicles only to appease environmentalists—and in fact want to continue manufacturing gasoline-powered engines—these alternative fuel sources will never be successful.

**The “Real” Cause of Death?** In 2006, Sony Pictures released the film, *Who Killed the Electric Car?*, which discussed the rise and fall of GM’s electric car and identified those responsible for its demise. Although the moviemakers blamed several parties, they felt the main catalyst for the failure of the EV1 was the creator itself, General Motors. This argument was supported by discussions about the true demand for the EV1 and its associated marketing techniques. In addition, the movie pointed to the U.S. Government’s significant role in the death of the EV1 because of its apparent support for the oil industry.

John Dabels, the head of GM’s marketing team in the early 1990s, said that “the sort of consumer enthusiasm for [the electric car] was something he had never seen before—thousands of people, literally from around the world, were lining up to get information about this innovative new electric car.” According to a poll released in May 1994 by the American Automobile Manufacturers Association, there was 60% support for the ZEV mandate, and nearly 30% of those polled were interested in buying an electric car if it were on sale for \$20,000 to \$30,000. Yet to this day, GM still maintains that lack of demand was the reason for discontinuing the vehicle. What GM has failed to divulge is that the application process to get an EV1 was difficult and burdensome with massive amounts of paperwork. Was GM trying to kill demand? Why would it not promote its new product?

As stated before, GM spent \$1 billion on the EV1. Was this money spent wisely and with the intent of great success? Commercials are a key method of advertising. When we think of car commercials, we think of beautiful people driving through scenic areas while the many benefits of the vehicle are described. GM took a different approach to commercials for the electric car. Rather than the beautiful and beneficial mindset, it chose an almost scary scene with a description of the vehicle’s (few) weaknesses. Is this a good way to promote a new car? Commercials drive demand for a product. In many cases, when there is no demand for a product, a company will change its marketing techniques. Once again, GM acted differently from the norm. Instead of trying a new marketing strategy, it chose to discontinue production. This is unusual, considering the \$1 billion it had already spent on the vehicle.

Another party linked to the collapse of the EV1 is the federal government, with its links to the oil industry. The EV1 took its first deep breath when a government agency in California mandated the use of electric cars, and if

the federal government had acted in a similar manner, the EV1 would have been breathing on its own for many years. The federal government, and in particular the Bush administration, chose not to act. The electric car could have served as an indicator of society's future attitude toward the environment. Did the administration not realize this breakthrough, or was it sidetracked by other factors? For instance, does the fact that Vice President Dick Cheney, Secretary of State Condoleezza Rice, former Chief of Staff Andrew Card, and former Energy Secretary Spencer Abraham have significant ties to the oil industry affect their policy decisions? Or does the fact that oil and gas companies contributed over \$46 million to Republicans during the 2000 and 2002 campaigns affect decision making? The Bush administration, for whatever reason, chose not to further the success of the EV1, and now, our environment faces the consequences of that decision.

In the 1990s, General Motors was a leader in the auto industry. Its push to create an electric car inspired others to act on behalf of the environment rather than for its own pockets. However, GM discontinued its leadership role. Rather than focus quality marketing efforts on this innovative technology, it crushed demand and took the product off its shelves. Sadly, GM had to decide which product to market, and it chose its "bread and butter" product, the internal combustion engine. GM faced a challenging ethical dilemma: whether to strive to protect the environment or achieve financial success. In the end, it decided the electric car was not the technology of the future. But who decided that it was GM's decision to make? Didn't GM have an ethical obligation to allow the consumer and the marketplace to decide that future?

**Epilogue: Who's Going to Save the Electric Car?** Bob Lutz, vice chairman for Product Development at General Motors, stated in a 2007 interview that "Now, it turns out that from a PR

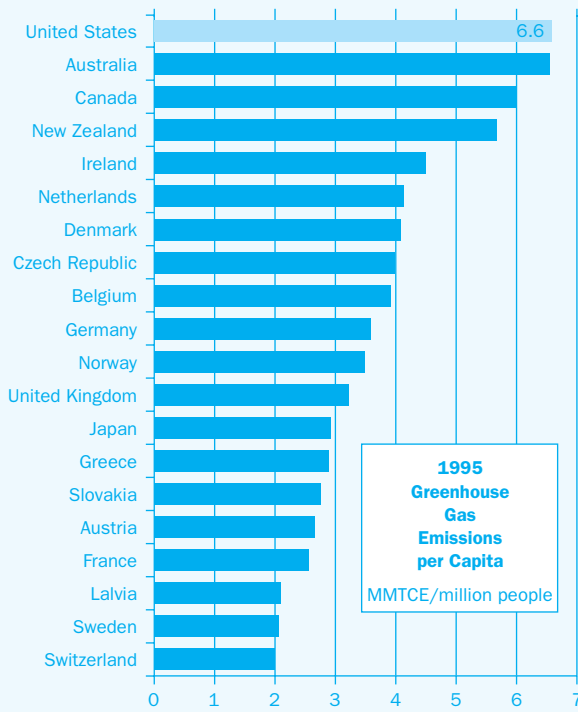
standpoint probably the dumbest move we ever made [was killing the EV1]. It was done for all the right legal reasons, but PR-wise it was dumb. So, now I'm getting e-mails saying, 'I hope you rot in hell.' Still, Lutz said that this time around, GM is "dead serious" about the electric car. Lutz and others have been working on GM's next electric car, called the Chevy Volt, that "...can run for 40 miles on a battery charge, which GM says is enough daily range for 82 percent of the population. But for longer trips, the Volt also has a tiny engine (either gas or ethanol, or hydrogen) that recharges the battery as you drive." At issue is the battery. GM labs is working on a new lithium-ion battery for the Volt that is long-lasting and safe. Also at issue is cost of the car. Lutz is aiming at a model under \$30,000.

Lutz said, "Will it live up to its promise of 40-plus mile electric range? Will the battery last ten years? Can we bring it in at a price that most people could afford? If the answer is 'yes' to all that, then I think the future for electrics is absolutely unlimited." While some experts in this field are skeptical given what happen to EV1, Chris Paine is excited; he said he has already started on a new movie sequel: "Who Saved the Electric Car?"

## Questions for Discussion

1. What killed the electric car according to facts in this case?
2. What does GM's decision to end production of the electric car have to do with business ethics? In your answer, consider stockholders' and stakeholders' best interests.
3. What are the pros and cons of the technologies that may replace the internal combustion engine?
4. If you were the CEO of GM, what decision would you have made about the EV1? (Refer to the Appendix before you answer.)
5. Based on the factors that allegedly "killed" the electric car, what are current factors that may now offer different results for this type of car's success in the market?

# Appendix



**SOURCE:** Adapted from the *Environmental Protection Agency Web site*, <http://yosemite.epa.gov/oar/globalwarming.nsf/content/emissionsindividual.html>.

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## Case 14

### Skype and Peer-to-Peer VoIP Technology: Too Good to Be True?

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In October, 2005, eBay completed its purchase of Voice-over Internet Protocol (VoIP) provider Skype for \$2.6 billion. This was a huge payout for the creators of the now infamous file-sharing company Kazaa. Kazaa gave its creators (two Scandinavians named Niklas Zennstrom and Janus Friis) fame and cult status but also left them hiding from the media and authorities, facing lawsuits, and with little money to show for their efforts. Their newest venture, Skype, was at this stage a tremendous success story, but it remained to be seen if eBay would be able to get its money's worth from the VoIP company that is based on the same peer-to-peer technology that was behind Kazaa.

Fast-forward to 2008: In April, 2008, rumors were swirling that eBay was considering selling Skype. The auction house had already written off \$1.4 billion from its original purchase. eBay "...has failed to integrate the technology into its core auction business, and although Skype continues to pick up users, it is still struggling to find a way to make much cash out of them. eBay dropped a new CEO into Skype in February—Josh Silverman—who was previously running the comparison service shopping.com." CEO John Donahoe, eBay president, reported that he would reevaluate the future of Skype if they could not find "strong synergies." "Three years after the acquisition some would say the synergies should be obvious by now." Whether or not eBay keeps Skype may also depend on how well the technology plays in the marketplace. How eBay envisions and acts on Skype's technological and financial potential also reveals eBay's visionary and strategic courage, common sense, and business acumen.

A sample from two bloggers shows users' experience with Skype. After viewing this section, we turn to an analysis

of Skype's technology in the marketplace with a question you may consider: "Should eBay sell or grow Skype?"

**"Wisdom of the Crowd"** First blogger:

"Skype.com definitely has one of the better Skype to Skype phone calls out there. Also, since it's free from one Skype user to the next, it's also a great service.

However, I think they are VERY misleading when it comes to fees. When looking over their fees for calls, the price to call the United States looked very good...about .017 per minute. The odd thing is that I don't even use a minute before charged more than this. I ripped through \$10 in about 2–3 weeks of occasional calls whereas with Voipwise, it took me 3+ months before I used the \$10. A huge difference! It will be good for eBay since they own Skype, but not for its users. It's not much of a deal unless you use their Skype to Skype service, in my humble opinion."

Another blogger:

I have been a Skype user for a few years. I have seen the service develop and improve. For me the pros of Skype are many and far outweigh the cons.

The Pros:

You can speak to any other broadband user in almost any country in the world for free.

Skype is freely available to download so any user of any broadband service can install the software. Some other internet telephony (VoIP, voice over internet protocol) services are ISP (internet service provider) specific.

You can use webcams so that you can see and be seen by the person (or people) you are speaking to.



Fantastic for friends and family overseas. I recently saw the 10 year old daughter of an old college friend via Skype. The last time I saw her she was a baby. . . . For a fee, Skype allows you to use your internet connection to call other people's landlines. . . .

Cons:

The quality of sound with VoIP isn't as good as on a landline or mobile.

If you use a webcam the sound quality deteriorates.

There is frequently background noise and the service can be subject to drop-outs.

Skype can be intrusive if you leave it set to show your contacts when you are online. I personally leave it set to invisible unless I am truly in the mood for random conversations.

While users offer criticism and praise for Skype, having a free service is a plus. However, certain annoyances with the service suggest improvements can—must—be made. We turn now to the technology driving Skype. As eBay's president—or as a member of its board—consider what information, knowledge, and moral courage you would need, along with your business savvy, to make a tough financial decision as you bet part of your company's future on a large acquisition—Skype.

**VoIP Technology** VoIP, simply stated, is the transmission of voice communications over the Internet. VoIP technology has traditionally used the server-client model. In this model packets of voice information are routed from a centralized server to individual clients in a process similar to the way other data is transferred over the Internet. A real advantage of using VoIP is the ability to use one network to carry both voice and data information, which is theoretically easier to deal with, and cheaper. In addition, calls can be routed to a VoIP phone anywhere as long as an Internet connection is available. A person can be on a business trip or vacation, and as long as she or he is

connected to the Internet, that person can receive a call as if he or she were sitting back in the office. Another advantage is the ability to combine other Internet services with VoIP. For example, e-mail and file exchanges, and even video conferencing, can be done while talking using VoIP technology.

There are also some disadvantages to VoIP. The first is reliability. With traditional phone lines there is a direct line from an individual or company's phone line to the telephone company's phone lines. With VoIP, the power is coming from the user's cable or DSL modem and so the source of that power comes from the electricity at that particular home or office.

The second reliability concern is that some high-speed connections may not be completely stable and so may cause packets to be delayed or even lost somewhere in the transfer process. This is significant because it can only partially be mitigated by what a company does on its own end. For home high-speed cable modem users, this can often be a problem because at times of high Internet traffic or congestion, the Internet connection is slower.

Another concern—that justifiably gets a lot of media attention—has to do with emergency calling. The very advantage of being able to send and receive calls anywhere on the network also makes emergency calling difficult. Without the direct line and set address that come with a traditional phone service, it is very hard for calls to be routed to a local call center. What's more, if the caller is unable to give an actual address, there may be no way for emergency personnel to locate him or her. The federal government is working to force VoIP providers to create workarounds and take steps to protect VoIP users in case of emergency but this is a gray area and the details are still being worked out. The emergency calling concerns are something that individuals and companies need to be aware of and be ready to deal with before committing to the adoption of VoIP technology as their primary telephone service.

## What Makes Skype Different

What makes Skype different from nearly all of the other VoIP providers is the fact that it is based on the same peer-to-peer (P2P) technology that Zennstrom and Friis used for their file-sharing company Kazaa. It is, in fact, the first VoIP service to be based on P2P technology. With P2P technology, Skype users are able to establish a direct connection with each other instead of having the information first go through a central server and then be routed to its final destination. The system is completely decentralized and relies on the individual users, or nodes, to maintain, strengthen and expand the network. The advantage for Skype is that the network can easily expand to very large sizes without the costs typically associated with a more centralized system and infrastructure. This technology has allowed Skype to rapidly expand to a user base of more than 65 million users.

The reason for the tremendous growth in users has to do primarily with cost, usability, and functionality. Skype is free to download. In fact, Skype's tagline is, "The whole world can talk for free." Not only is it free, the installation process itself is very simple; a person can have Skype installed and be making calls to other Skype users in a matter of minutes. In addition, Skype also offers a free video calling capability to its basic downloadable product. In a matter of minutes, users with a webcam or camcorder can actually see the people they are talking to. This is a very appealing alternative to the more complicated traditional VoIP providers that typically require new equipment and a lengthier set-up process.

Calls are free, however, only between Skype users on the network. Once users want to add functionality beyond this free feature, it is going to cost them, which is also how Skype makes money. In order to make and receive calls to and from people not currently using Skype, the company has created SkypeOut and SkypeIn. SkypeOut makes it possible to call traditional phones all over the world from Skype.

To get this capability, Skype users simply go to their Skype account page, prepay for an amount of credit that they want, and start making calls. The current global rate for Skype users in the most popular destinations worldwide is just over \$0.02 per minute, which is a very competitive price and a tempting offer compared to other long-distance solutions.

In order to be able to receive calls from traditional phones, Skype users must purchase a SkypeIn number. The current subscription costs for a SkypeIn number are about \$12 for three months and \$36 for one year. Customers have the choice of selecting whatever regular phone number they want. The advantage is that a person who lives in Boston, for example, but who has family in Idaho, can choose an Idaho phone number as his or her Skype number. Friends and family in Idaho can then make a local call, even though the Skype customer is in Boston.

**Cause for Concern** It sounds like a great application and a wonderful solution, so why are some people and companies nervous about using Skype? The more people learn about Skype, the more they have questions about the technology behind it. As a November 2005 *BusinessWeek* article pointed out, when a company is bought for \$2.6 billion, there is a certain amount of curiosity and scrutiny. So what, specifically, are people nervous about, other than the emergency calling issues that plague nearly every other VoIP service provider? A broad concern held by many has been that the Skype code is a proprietary and closed source. This makes it difficult for other providers to have any interaction with, or access to, the Skype network, which protects Skype's technology and unique features but eliminates the potential for some add-ons and cross-functionality. This also means that there is really no way to verify how secure Skype is, so users have to believe Skype when the company says the system is safe.

However, the newfound attention has indeed shed more light on how, exactly, Skype is using P2P technology in its VoIP service. As with Kazaa and other P2P file-sharing technologies, Skype is able to bypass firewalls by routing packets of information through other users on the network and yet its presence, and this process, is difficult to trace. The P2P technology enables Skype to control some of the network ports on computers and possibly manipulate the firewall that that particular computer is running. And if the first firewall port that Skype attempts to manipulate is blocked, the program will keep searching until it finds a firewall port that is open and available. Once one has been found, Skype leaves it open as it passes packets of voice data through the port. This poses a threat as the hole, or open port, can now act as a back door into secure networks. Hackers can then use this back door to turn loose malicious attacks from worms, viruses, or other damaging code.

A second significant concern with Skype is the issue of bandwidth. As mentioned earlier, because Skype uses P2P technology, it relies on users, and more specifically, users' computers and bandwidth to strengthen and expand its network of callers. If a Skype user is on an unrestricted network and leaves Skype running, even when it is not in use, that user can become what is called a P2P "supernode." A supernode has the ability to dramatically strengthen Skype as it can assist with the routing of voice information packets for users who are operating under a more secure network. If a user becomes a supernode, Skype will essentially use any bandwidth available to perform this routing, which can severely slow down network performance, leaving little bandwidth leftover for other important tasks.

Finally, a third concern is with unsolicited phone calls from other users on the Skype network. Part of the appeal, and advantage, of using Skype is that users can create profiles of themselves that can be viewed by others on the network. Users have the option of mak-

ing their profile known to others when they are online, but this is where it gets tricky. Friends and family members living in different parts of the country, and even the world, will want to be able to know when the others are online and if they have Skype running. But making a profile available also means that anyone else on the network can see it and make an unsolicited call. It is a mix between spam and telemarketers, which can be very frustrating to all involved. Simply put, the spotlight is shining on Skype, as many are realizing that it is indeed a P2P program similar to its file-sharing predecessors, which means it not only has many of the same great benefits but also the potential threats.

### **Back-to-Business: Troubled Waters or Full Steam Ahead?**

One writer in July 2007 stated in *SkypeJournal*, an independent news and blog service:

By every metric, Skype continues its midflight stall. Despite doing bunches of things right, Skype's core value is dying. Skypers aren't calling any more now than they were before. SkypeOut minutes didn't change. Free Skype-to-Skype calling fell this quarter, back to where it was a year ago... Flat growth turns regional growth into a zero-sum game. With flat Skype-to-Skype growth, a minute gained in one market equals a minute lost elsewhere. In which markets is Skype losing ground? Where are defectors going? The signups aren't enough to cover churn. 24 million new user accounts in Q2 looks amazing, doesn't it? 183 signups a minute, 263k new accounts a day. But... This growth is too small. At 12% quarter over quarter growth, this can't be replacing who people who leave the Skype network. People who create accounts include those who just try Skype ("kicking the tires"), those who abandon VoIM for mobile or landlines, and defectors switching to broadband operators or other VoIP/VoIM

providers. If signups don't cover customers leaving, Skype is in danger... Is Skype's competition Jajah, Vonage or AT&T?

About a Year Later: The CEO of eBay responded to an interview question:

**Question.** I couldn't help but notice that even though Skype is our lowest earner (\$126 million), it is our most aggressive earner at 61% year-over-year growth and, with more than 309 million users around the world, it now has the largest user base of any eBay business. What does that mean long-term? Is that growth sustainable?

**Answer.** Skype is a four year-old business and its growth rate is nothing short of incredible. It represents a massive user base benefiting from one of the things that made eBay and PayPal so great—network effects.

One user brings another user who brings another user. From that you have a rapidly growing community of users getting more and more engaged with the service. After 4 years, 309 million users is an amazing accomplishment by the Skype team.

Our focus now is on improving the user experience; enhancing the ability for them to communicate through high-quality video; expanding the number of devices you can use when you're away from your desktop so that Skype is more mobile in its application.

The implication for Skype in the future is about as big as our dreams can make it. Our challenge is in prioritizing and executing on those dreams so we can continue the trajectory we've experienced over the past couple of years.

In July, 2008, eBay reported "solid second-quarter earnings...posting a 22 percent profit increase with numbers toward the high end of analysts' consensus...quarterly revenue of \$2.2 billion, up by 20 percent (\$361 million) over

revenue of \$1.8 billion during the same time last year. Net income was \$460 million, or 35 cents per diluted share. On a non-GAAP basis, eBay claimed a profit of \$568 million, or earnings per share of 43 cents, which topped both analysts' consensus and its own guidance by 2 cents a share." The president and CEO, John Donaho, noted that "Net revenue for PayPal increased 33% year-over-year to \$602 million for the second quarter." No mention of Skype was made either by eBay's president or its CFO in this news report.

### The eBay Acquisition and the Future of Skype

Many still wonder why eBay was willing to pay \$2.6 billion for a company that has yet to turn a profit, and the opinion of many in the industry is that eBay overpaid. The price may indeed reflect some of the speculation that was so rampant before the tech bubble burst, but eBay must see great potential in this acquisition to continue to support one of the poorest performing parts of its business. For example, it was the opportunity for eBay to use Skype to enhance the products and services that had eBay and many others excited. But it was also important to note that Skype was going to continue to operate as a stand-alone VoIP service, with no signs of slowing down. The company was not only adding hundreds of thousands of customers each month but was pressing ahead with new phones and other telecommunications hardware aimed at making Skype even more user friendly.

eBay hopes and continues to bet on Skype becoming profitable, although the process has been slow and is still sometimes questionable. Nevertheless, eBay has moved forward to integrate Skype into its current services. The first obvious application would be to add Skype as a function in the traditional buying, selling, and auction marketplace that eBay has been so successful at. For example, instead of a buyer emailing a seller with questions about a particular item for sale, a buyer could use Skype to contact the

seller and have a conversation, or even negotiation, in real time. This would be especially useful in the case where an auction is about to end, the potential buyer has questions that need to be answered before he or she will bid, but doesn't have time to wait for an e-mail reply. In addition, Skype could allow eBay to make progress in countries where haggling, or negotiation, is a necessary part of any purchase. The functionality Skype offers would make this possible, but the Skype name alone would increase credibility as Skype has a very strong international presence and is well known in many countries that eBay has yet to penetrate.

Another potential application is in the lead-generation business (i.e., producing opportunities for sales). Currently, many sellers have paid ads on eBay and are able to generate leads through the clicking that customers do on their ads. With Skype, instead of clicking, potential buyers can call sellers while they are online looking at advertisements. This functionality could be a real asset to eBay in some of the company's current markets, like used cars and high-end collectibles. But this new form of lead generation could also help eBay gain a foothold in new markets like new cars, real estate, and travel.

There are several other applications that eBay, and Skype, will explore in the near future, if eBay keeps the company. The possibilities—and hopes!—are still exciting for supporters of Skype as VoIP technology continues to improve and the industry matures. As has been pointed out, there are some concerns with VoIP technology and especially with P2P VoIP technology like Skype. Yet despite these concerns, new companies are entering the market and hundreds of thousands of users continue to race to sign up. Keep in mind that the P2P file-sharing services were, and are, wildly popular but have been unable to find mainstream success because of copyright and other legal concerns. Thus far, the FCC has chosen not to regulate VoIP but has also decided to take a closer look at VoIP technology

and providers. And VoIP regulations also vary wildly in other countries. How the FCC and other countries ultimately decide to regulate VoIP will go a long way towards determining the success of Skype and eBay's acquisition of Skype.

## Questions for Discussion

1. What are the major issues for eBay to keep or sell Skype? Explain.
2. As a user of Skype, assuming you are or have been, how would you evaluate that service and technology? Does Skype have a future according to your experience and judgment?
3. What moral responsibilities do you as eBay's president (hypothetically) have toward your shareholders and stakeholders with regard to keeping or selling Skype? Explain.
4. Using ethical reasoning from Chapter 3, and from your own beliefs, state an argument that you as president of eBay would make to your board of directors, shareholders and stakeholders to keep or sell Skype.
5. What specific lessons do you take from this case that are relevant to your "business ethics"? Explain.

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This case was written by Dax Jacobson, Bentley College, under the direction of Joseph W. Weiss, for classroom discussion, and not for any type of official or unofficial decision making by personnel or management. Sources cited and used in the case are in the public domain. This case was developed from material contained in the following sources:

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  65. The following excerpts are based on these sources: Geyelin, M. (Aug. 27, 2001). For Firestone, tire trial is mixed victory. *Wall Street Journal*, A3; Belsie, 1; Sissell, K. (Dec. 8, 1999). Judge approves Dow Corning bankruptcy plan. *Chemical Week*, 21; Bloomberg News. (May 17, 2001). Payout in 2001 in diet cases to be \$7 billion. *New York Times*, C.7; Donaldson, T., Werhane, P. (1988). *Ethical Issues in Business: A Philosophical Approach*, 89–100, 414–414. Englewood Cliffs, NJ: Prentice-Hall; Barrett. (April 3, 1985). Dalkon Shield maker concedes possible user injuries. *Dallas Times Herald*, A8; Buchholz, R. A. (1989). *Fundamental Concepts and Problems in Business Ethics*. Englewood Cliffs, NJ: Prentice Hall; Geyelin, M. (Nov. 12, 1991). Dalkon Shield trust lawyers draw fire. *Wall Street Journal*, B5; Matthews, J., Goodpaster, K., Nash, L. (1991). *Policies and Persons: A Casebook in Business Ethics*, 2d ed. New York: McGraw-Hill.

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# 5

## CORPORATE RESPONSIBILITIES, CONSUMER STAKEHOLDERS, AND THE ENVIRONMENT

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### OPENING CASE

"The rate of obesity in the United States has doubled in the last 30 years, and those extra pounds weigh on companies' bottom lines, according to a new report from *The Conference Board*. Thirty-four percent of American adults fit the definition of 'obese.' Obese employees cost U.S. private employers an estimated \$45 billion annually in medical expenditures and work loss."<sup>1</sup> Obesity and overall weight gain in the American population changed from a problem to a crisis when it was made an issue of public concern in 2002–2003—at which time the Food and

Drug Administration (FDA) and the National Center for Health Statistics (NCHS) released summary statistics about America's weight problem.<sup>2</sup> Looking back, a survey conducted from 1999–2002 indicated that approximately 65% of the United States' adult population is overweight or obese. This represented a 16% jump in the rate of overweight and obese adults from the last survey conducted from 1988–1994. An even more striking statistic is found in the weight increase experienced by children and adolescents in the United States. Current research

estimates that 16% of children and adolescents, ages 6 to 19, are overweight or obese, up 45% from the last survey conducted from 1988–1994. Carrying excess weight causes an increased risk for medical conditions, including coronary heart disease, stroke, hypertension, sleep apnea, and some forms of cancer.<sup>3</sup> The problem has become so profound that the U.S. Health and Human Services Department has actually declared obesity a disease affecting the population.<sup>4</sup>

In a recent survey of 1,000 households, conducted for *Medicine & Law Weekly*, results showed that 51% of the households would like to see fast food restaurants under the regulation of the government, while only 37% were opposed to such an action.<sup>5</sup> Consumers are suggesting that they are looking for more regulations to be placed on the fast food industry to provide them with a wider variety of healthier meal options.

Another reason cited for the overall increase in overweight and obese individuals in the U.S. is the ease of selecting calorie-packed foods and the high cost associated with eating healthy. The Centers for Disease Control has pointed out that the availability of foods that are high in fat, sugar, and calories has made it increasingly more convenient for consumers to select those foods.<sup>6</sup> In the region surrounding Mobile, Alabama, an area of the United States where produce is most expensive relative to other grocery products, the study found the highest amount of weight gained by children, about 50% higher than the national average.<sup>7</sup>

Fast food chains have reacted to consumers' demand for healthier menus by making changes to their menus and marketing strategies. McDonald's has a new "Go Active" campaign, featuring new, healthy menu items such as salads topped with chicken and a new fruit and walnut salad. Wendy's saw its weekly sales of low-fat milk increase 15 times when it packaged the milk in creative containers and offered it as a substitute; McDonald's milk sales doubled in 2004, when consumers were not choosing surgery sodas, but making healthier choices instead.<sup>8</sup> Subway leveraged the story of Jared Fogle, the Indiana University student who once weighed 425 pounds. By making Subway's healthy sandwiches a part of his daily diet, and combining them with regular exercise, Fogle was able to lose 245 pounds in a year.<sup>9</sup> The FDA has also joined the fight against obesity by initiating programs to "count calories." Its goals include pressuring fast food companies to provide more detailed and accurate information about nutrition content to their diners as well as educating consumers. With the partnership between the fast food chains and the FDA, consumers stand to be better informed about their options to become and remain healthy. Restaurants and company Web sites now provide consumers with nutritional information for menu items. Restaurants have teamed up with nutritionists who can offer helpful suggestions. When presented with healthier options, it's in the hands of consumers to make the right choices to improve their health.

## 5.1 CORPORATE RESPONSIBILITY TOWARD CONSUMER STAKEHOLDERS

As the largest national economy in the world, the U.S. produced \$13.86 trillion worth of goods and services (Gross Domestic Product) in 2007.<sup>10</sup> Consumer spending in the U.S. accounts for about two-thirds of total economic activity. Consumers may be the most important stakeholders of a business. If consumers do not buy, commercial businesses cease to exist. The late management guru Peter Drucker stated that the one true purpose of business is to create a customer.<sup>11</sup> Consumer confidence and spending are also important indicators of economic activity and business prosperity.

Consumer interests should be foremost when businesses are designing, delivering, and servicing products. Unfortunately, this often is not the case. As the opening case shows, giving customers what they want may not be what they need; also, not all products are planned, produced, and delivered with consumers' best health or safety interests in mind. Many companies have manufactured or distributed unreliable products, placing consumers at risk. The effects (and side effects) of some products have been life-threatening—even leading to death—including the Merck drug VIOXX (allegedly), the Bridgestone/Firestone tires on the Ford Explorer, tobacco products and cigarettes that contain nicotine, the Ford Pinto, lead-painted toys, and numerous other examples. At the same time, the majority of products distributed in the U.S. are safe, and people could not live the lifestyles they choose without products and services. What, then, is the responsibility of corporations toward consumer stakeholders?

## Corporate Responsibilities and Consumer Rights

Two landmark books that inspired the consumer protection movement in the U.S. were Upton Sinclair's *The Jungle* (1906), which exposed the unsafe conditions at a meat-packing facility, and Ralph Nader's *Unsafe at Any Speed* (1965), which created a social expectation regarding safety in automobiles. A third book, George Ritzer's *The McDonaldization of Society* (1995), explores the pervasive influence of fast-food restaurants on different sectors of American society, as well as on the rest of the world. In providing "bigger, better, faster" service and questionable food products, McDonald's has been the leader in creating—or reinforcing—a lifestyle change that, as the opening case shows, contributes to obesity. Morgan Spurlock's 2004 documentary, *Super Size Me*, also explored the fast food industry's corporate influence and encouragement of poor nutrition for profit. As Steven Fink's issues evolution framework in Chapter 2 illustrated, a "felt need" arises from books, movies, events, and advocacy groups, and builds to "media coverage." This then evolves into interest group momentum, from which stakeholders develop policies and later legislation at the local, state, and federal level. This same process has occurred and continues to occur with consumer rights. The books and documentary mentioned here have contributed to articulating and mobilizing the issues of obesity, unsafe cars, and quality of life to the public.

The following universal policies were adopted in 1985 by the United Nations' Assembly to provide a framework for strengthening national consumer protection policies around the world. Consider which policies apply to you as a consumer:

1. **The right to safety:** To be protected against products, production processes, and services which are hazardous to health or life.
2. **The right to be informed:** To be given facts needed to make an informed choice, and to be protected against dishonest or misleading advertising and labeling.
3. **The right to choose:** To be able to select from a range of products and services, offered at competitive prices, with an assurance of satisfactory quality.

4. **The right to be heard:** To have consumer interests represented in the making and execution of government policy, and in the development of products and services.
5. **The right to satisfaction of basic needs:** To have access to basic essential goods and services, adequate food, clothing, shelter, health care, education and sanitation.
6. **The right to redress:** To receive a fair settlement of just claims, including compensation for misrepresentation, shoddy goods or unsatisfactory services.
7. **The right to consumer education:** To acquire knowledge and skills needed to make informed, confident choices about goods and services while being aware of basic consumer rights and responsibilities and how to act on them.
8. **The right to a healthy environment:** To live and work in an environment which is non-threatening to the well-being of present and future generations.<sup>12</sup>

From an ethical perspective, corporations have certain responsibilities and duties toward their customers and consumers in society:

- *The duty to inform* consumers truthfully and fully of a product or service's content, purpose, and use.
- *The duty not to misrepresent or withhold information* about a product or service that would hinder consumers' free choice.
- *The duty not to force or take undue advantage* of consumer buying and product selection through fear or stress or by other means that constrain rational choice.
- *The duty to take "due care" to prevent any foreseeable injuries or mishaps* a product (in its design and production or in its use) may inflict on consumers.<sup>13</sup>

While these responsibilities seem reasonable, there are several problems with the last responsibility, known as "due care" theory. First, there is no straightforward method for determining when "due care" has been given. What should a firm do to ensure the safety of its products? How far should it go? A utilitarian principle has been suggested, but problems arise when use of this method adds costs to products. Also, what health risks should be measured and how? How serious must an injury be? The second problem is that "due care" theory assumes that a manufacturer can know its products' risks before injuries occur. Certainly, testing is done for most high-risk products; but for most products, use generally determines product defects. Who pays the costs for injuries resulting from product defects unknown beforehand by consumer and manufacturer? Should the manufacturer be the party that determines what is safe and unsafe for consumers? Or is this a form of paternalism? In a free market (or at least a mixed economy), who should determine what products will be used at what cost and risk?<sup>14</sup>

Related to the rights presented above, consumers also have in their implied "social contract" with corporations (discussed in Chapter 4) the following rights:

- *The right to safety*—to be protected from harmful commodities.
- *The right to free and rational choice*—to be able to select between alternative products.

- *The right to know*—to have easy access to truthful information that can help in product selection.
- *The right to be heard*—to have available a party who will acknowledge and act on reliable complaints about injustices regarding products and business transactions.
- *The right to be compensated*—to have a means to receive compensation for harm done to a person because of faulty products or for damage done in the business transaction.<sup>15</sup>

These rights are also constrained by free-market principles and conditions. For example, “products must be as represented: Producers must live up to the terms of the sales agreement; and advertising and other information about products must not be deceptive. Except for these restrictions, however, producers are free, according to free-market theory, to operate pretty much as they please.”<sup>16</sup>

**“Buyer Beware” and “Seller Take Care”** The 1800s concept of “let the buyer beware” principle plays well according to free-market theory, because this doctrine underlies the topic of corporate responsibility in advertising, product safety, and liability. In the 1900s, the concept of “let the seller take care” placed responsibility of product safety on corporations<sup>17</sup> (which we discuss later in this chapter under product liability). Several scholars argue that Adam Smith’s “invisible hand” view is not completely oriented toward stockholders. For example, Szwajkowski argues that “Smith’s viewpoint is most accurately positioned squarely between those who contend firms should act out of self-interest and those who believe corporations should be do-gooders. This middle ground actually embodies the stakeholder perspective. That is, stakeholders are in essence the market in all its forms. They determine what is a fair price, what is a successful product, what is an unacceptable strategy, what is intolerable discrimination. The mechanisms for these determinations include purchase transactions, supplier contracts, government regulation, and public pressure.”<sup>18</sup> The author continues, “Our own empirical research has clearly shown that employee relations and product quality and safety are the most significant and reliable predictors of corporate reputation.”<sup>19</sup>

## Consumer Protection Agencies and Law

Because of imperfect markets and market failures, consumers are protected to some extent by federal and state laws in the United States. Five goals of government policymakers toward consumers include:

1. Providing consumers with reliable information about purchases.
2. Providing legislation to protect consumers against hazardous products.
3. Providing laws to encourage competitive pricing.
4. Providing laws to promote consumer choice.
5. Protecting consumers’ privacy.<sup>20</sup>

Some of the most notable U.S. consumer protection agencies include:

1. *The Federal Trade Commission (FTC)* deals with online privacy, deceptive trade practices, and competitive pricing.



2. *The Food and Drug Administration (FDA)* regulates and enforces the safety of drugs, foods, and food additives, and sets standards for toxic chemical research.
3. *The National Highway Traffic Safety Administration (NHTSA)* deals with motor vehicle safety standards.
4. *The National Transportation Safety Board (NTSB)* handles airline safety.
5. *The Consumer Product Safety Commission (CPSC)* sets and enforces safety standards for consumer products.
6. *The Department of Justice (DOJ)* enforces consumer civil rights and fair competition.

Governmental and international agencies also work to protect consumers' legal rights. *Consumer World's* Web site (<http://www.consumerworld.org/pages/agencies.htm>) has an extensive list of consumer protection agencies that includes both the United States and international countries, including India, Estonia, Hong Kong, Korea, Mexico, and Canada, as well as other European countries. The 2007 report from the Commission of the European Communities reported that "the 493 million EU consumers are central to the three main challenges facing the EU: growth, jobs and the need to re-connect with our citizens . . . . In the period 2007–2013, consumer policy is uniquely well placed to help the EU rise to the twin challenges of growth and jobs and re-connecting with its citizens. The Commission will have two main objectives over this period:

- To empower EU consumers . . . . Empowered consumers need real choices, accurate information, market transparency and the confidence that comes from effective protection and solid rights.
- To enhance EU consumers' welfare in terms of price, choice, quality, diversity, affordability and safety. Consumer welfare is at the heart of well-functioning markets.<sup>21</sup>

## 5.2 CORPORATE RESPONSIBILITY IN ADVERTISING

Advertising is big business. Direct marketing advertising resulted in approximately \$173.2 billion at the end of 2007. That figure is expected to reach \$183.1 billion in 2008.<sup>22</sup> Figure 5.1 shows the top industry spenders on advertising during the first months of 2008. The extent to which advertising is effective is debatable, but because consumers are so frequently exposed to ads, it is an important topic of study in business ethics. The purpose of advertising is to inform customers about products and services and to persuade them to purchase them. Deceptive advertising is against the law. A corporation's ethical responsibility in advertising is to inform and persuade consumer stakeholders in ways that are not deceitful. This does not always happen, as the tobacco, diet, and fast food industries, for example, have shown.

Figure 5.1

Advertising Volume by Industry, January/February 2008

Industry	Total Impressions, February 2008 (M)
1. Web media	72,324.2
2. Financial services	64,358.1
3. Retail goods and services	46,826.6
4. Telecommunications	24,162.9
5. Consumer goods	12,411.2
6. Public services	9,810.5
7. Entertainment	7,134.1
8. Automotive	8,683.4
9. Travel	8,542.5
10. Health	7,353.1
11. Software	5,939.6
12. Hardware and electronics	5,665.7
13. Business-to-business	4,226.5

**SOURCE:** Advertising Placements by Industry and Top Sponsored Links, February 2008. (Apr 11, 2008). Nielsen Online, <http://searchenginewatch.com/showPage.html?page=3629091>.

Ethics and Advertising

At issue, legally and ethically, for consumers is whether advertising is deceptive and creates or contributes to creating harm to consumers. Although advertising is supposed to provide information to consumers, a major aim is to sell products and services. As part of a selling process, both buyer and seller are involved. As discussed earlier, “buyer beware” imparts some responsibility to the buyer for believing and being susceptible to ads. Ethical issues arise whenever corporations target ads in manipulative, untruthful, subliminal, and coercive ways to vulnerable buyers such as children and minorities. Also, inserting harmful chemicals into products without informing the buyer is deceptive advertising. The tobacco industry’s use of nicotine and addictive ingredients in cigarettes was deceptive advertising.

The American Association of Advertising (AAA) has a code of ethics that helps organizations monitor their ads. The code cautions against false, distorted, misleading, and exaggerated claims and statements as well as pictures that are offensive to the public and minority groups. The following questions can be used by both advertising corporations and consumers to gauge the ethics of ads:

1. Is the consumer being treated as a means to an end or as an end? And what and whose end?
2. Whose rights are being protected or violated intentionally and inadvertently? And at what and whose costs?

3. Are consumers being justly and fairly treated?
4. Are the public welfare and the common good taken into consideration for the effects as well as the intention of advertisements?
5. Has anyone been or will anyone be harmed from using this product or service?

## The FTC and Advertising

The Federal Trade Commission (FTC) and the Department of Labor (DOL) are the federal agencies in the United States appointed and funded to monitor and eliminate false and misleading advertising when corporate self-regulation is not used or fails. Following is a sample of the FTC's guidelines:

The Federal Trade Commission Act allows the FTC to act in the interest of all consumers to prevent deceptive and unfair practices. In interpreting Section 5 of the act, the Commission has determined that a representation, omission or practice is *deceptive* if it is likely to:

- mislead consumers
- affect consumers' behavior or decisions about the product or service

In addition, an act or practice is *unfair* if the injury it causes, or is likely to cause, is:

- substantial
- not outweighed by other benefits
- reasonably avoidable

The FTC Act prohibits unfair or deceptive advertising in any medium. A claim can be misleading if relevant information is left out or if the claim implies something that's not true. For example, a lease advertisement for an automobile that promotes "\$0 Down" may be misleading if significant and undisclosed charges are due at lease signing. In addition, claims must be *substantiated*, especially when they concern health, safety, or performance. The type of evidence may depend on the product, the claims, and what experts believe is necessary. If your ad specifies a certain level of support for a claim—"tests show X"—you must have at least that level of support.

Sellers are responsible for claims they make about their products and services. Third parties—such as advertising agencies or Web site designers and catalog marketers—also may be liable for making or disseminating deceptive representations if they participate in the preparation or distribution of the advertising or know about the deceptive claims.<sup>23</sup>

## Pros and Cons of Advertising

Advertising is part of doing business, and not all advertising is deceptive or harmful to consumers. The criticisms, both for and against advertising, raise awareness that provides information to both companies and consumers in their production and consumption of information

## ETHICAL INSIGHT 5.1

**Signs of an Advance-Fee Loan Scam: “Red Flags” from the FTC**

- **A lender who isn’t interested in your credit history.** A lender who doesn’t care about your credit record should give you cause for concern. Ads that say “Bad credit? No problem” or “We don’t care about your past. You deserve a loan” or “Get money fast” or even “No hassle—guaranteed” often indicate a scam.
- **Fees that are not disclosed clearly or prominently.** Any up-front fee that the lender wants to collect before granting the loan is a cue to walk away, especially if you’re told it’s for “insurance,” “processing,” or just “paperwork.” Legitimate lenders often charge application, appraisal, or credit report fees. It’s also a warning sign if a lender says they won’t check your credit history, yet asks for your personal information, such as your Social Security number or bank account number.
- **A loan that is offered by phone.** It is illegal for companies doing business in the U.S. by phone to promise you a loan and ask you to pay for it before they deliver.
- **A lender who uses a copy-cat or wanna-be name.** Crooks give their companies names that sound like well-known or respected organizations and create Web sites that look slick.
- **A lender who is not registered in your state.** Lenders and loan brokers are required to register in the states where they do business. To check registration, call your state attorney general’s office or your state’s Department of Banking or Financial Regulation.

**SOURCE:** Facts for consumers, Advance-fee loan scams: “Easy” cash offers teach hard lessons. *Federal Trade Commission*, <http://www.ftc.gov/bcp/edu/pubs/consumer/telemarketing/tel16.shtm>, accessed June 17, 2008.

and transactions. General ethical arguments for and against advertising are summarized here:

**Arguments for Advertising** Arguments that justify advertising and the tactics of puffery and exaggeration include:

1. Advertising introduces people to and influences them to buy goods and services. Without advertising, consumers would be uninformed about products.
2. Advertising enables companies to be competitive with other firms in domestic and international markets. Firms across the globe use advertisements as competitive weapons.
3. Advertising helps a nation maintain a prosperous economy. Advertising increases consumption and spending, which in turn creates economic growth and jobs, which in turn benefits all. “A rising tide lifts all ships.”

4. Advertising helps a nation's balance of trade and debt payments, especially in large industries, such as the food, automobile, alcoholic beverage, and computer technology industries, whose exports help the country's economy.
5. Customers' lives are enriched by the images and metaphors advertising creates. Customers pay for the illusions as well as the products advertisements promote.
6. Consumers are not ignorant. Buyers know the differences between lying, manipulation, and colorful hyperbole aimed at attracting attention. Consumers have freedom of choice. Ads try to influence desires already present in people's minds. Companies have a constitutional right to advertise in free and democratic societies.<sup>24</sup>

**Arguments against (Questionable) Advertising** Critics of questionable advertising practices argue that advertising can be harmful for the following reasons. First, advertisements often cross that thin line that exists between puffery and deception. For example, unsophisticated buyers, especially youth, are targeted by companies. David Kessler, former commissioner of the FDA, referred to smoking as a pediatric disease, since 90% of lifelong smokers started when they were 18 and half began by the age of 14.<sup>25</sup>

Another argument is that advertisements tell half-truths, conceal facts, and intentionally deceive with profit, not consumer welfare, in mind. For example, the \$300 billion to \$400 billion food industry is increasingly being watched by the FDA for printing misleading labels that use terms such as "cholesterol free," "lite," and "all natural." Consumers need understandable information quickly on how much fat (a significant factor in heart disease) is in food, on standard serving sizes, and on the exact nutritional contents of foods.<sup>26</sup> At stake in the short term for food companies is an outlay of between \$100 million and \$600 million for relabeling. In the long term, product sales could be at risk. As the opening case argued, one of the great paradoxes of Americans today is their obsession with diet and health while having one of the worst diets in the world. Also noted earlier, about 64% of adults are considered overweight, and only 2% of children eat the recommended variety of foods daily. Food industry executives say that customers ask for low-fat food but rarely buy it. For many Americans, the problem is not just that they are consuming so much fat, it is that they don't know what they are eating. The government-recommended daily caloric intake of 19- to 30-year-old males in the U.S. is 3000 for those who are active and 2600–2800 for the moderately active; the recommended calories for 19- to 30-year-old active females is 2400 and 2000–2200 for the moderately active. Many Americans far exceed those recommendations, in part because of their increasing reliance on restaurant food.<sup>27</sup>

## Advertising and Free Speech

Because ads are often ambiguous, sometimes misleading, and omit essential facts, the legal question of "free speech" enters more serious controversies. In commercial speech cases, there is no First Amendment protection if it can be

proven that information was false or misleading. In other types of free speech cases, people who file suit must prove either negligence or actual malice.<sup>28</sup>

Should certain ads by corporations be banned or restricted by courts? For example, should children be protected from accessing pornography ads on the Internet? Should companies that intentionally mislead the public when selling their products be denied protection by the court?<sup>29</sup> The U.S. Supreme Court has differentiated commercial speech from pure speech in the context of the First Amendment. (See *Central Hudson Gas and Electric Corporation v. Public Service Commission*, 1980, and *Posadas de Puerto Rico Associates v. Tourism Company of Puerto Rico*, 54 LW 4960). Pure speech is more generalized, relating to political, scientific, and artistic expression in marketplace dealings. Commercial speech refers to language in ads and business dealings. The Supreme Court has balanced these concepts against the general principle that freedom of speech must be weighed against the public's general welfare. The four-step test developed by Justice Lewis F. Powell Jr. and used to determine whether commercial speech in advertisements can be banned or restricted follows:

1. Is the ad accurate, and does it promote a lawful product?
2. Is the government's interest in banning or restricting the commercial speech important, nontrivial, and substantial?
3. Does the proposed restriction of commercial speech assist the government in obtaining a public policy goal?
4. Is the proposed restriction of commercial speech limited only to achieving the government's purpose?<sup>30</sup>

For example, do you agree or disagree with the conservative plurality on the U.S. Supreme Court that has argued in the tobacco smoking controversy to give more free speech rights to tobacco companies? (As suggested by Lawrence Gostin, "The [U.S. Supreme] [C]ourt has held that the FDA lacks jurisdiction to regulate cigarettes. The court observed that Congress, despite having many opportunities, has repeatedly refused to permit agency regulation of the product. Thus, Congress has systematically declined to regulate tobacco but has also preempted state regulation. Moreover, the Supreme Court's recent assertion of free speech rights for corporations prevents both Congress and the states from meaningfully regulating advertising. To the extent that commercial speech becomes assimilated into traditional political and social speech, it could become a potent engine for government deregulation. And, perhaps, that is the agenda of the court's conservative plurality.")<sup>31</sup>

The commercial speech doctrine remains controversial. The Supreme Court has turned to the First Amendment to protect commercial speech (which is supposedly based on informational content). Public discourse is protected to ensure the participation and open debate needed to sustain democratic traditions and legitimacy. The Supreme Court has ultimate jurisdiction over decisions regarding the extent to which commercial speech, in particular, ads, and cases meets the previous four standards.

Recent judicial decisions regarding a number of areas (including consumer privacy, spam, obesity, telemarketing, tobacco ads, casino gambling advertising, and dietary supplement labeling [see *Greater New Orleans Broadcasting Association Inc. v. United States* and *Pearson v. Shalala*]), have sent a message that

## ETHICAL INSIGHT 5.2

## Erin Brockovich on Freedom to Advertise

Consumer advocate Erin Brockovich has a well-deserved reputation for confronting corporate giants, and in her online newsletter she recently took aim at the pharmaceutical company GlaxoSmithKline and its popular anti-diabetic drug Avandia (rosiglitazone). Referring to a major scientific study in the *New England Journal of Medicine*, which found that Avandia substantially increased the risk of heart attacks and strokes, she said, “Some Avandia patients won’t take their medication. Some Avandia patients have an increased risk of heart attack. Some people take Avandia and have heart attacks. Some of them die. Some of them didn’t have to.”

Such provocative claims, coupled with the fact that Brockovich advertises on the Internet, have led critics to warn against “the dangers of attorney advertising in drug litigation.” For example, a posting on PointofLaw.com, a web magazine sponsored by the free-market think tank Manhattan Institute, said that “drug litigation is about trial lawyer profits, rather than public health. Indeed, a Google search for Avandia turns up eight or nine ads from trial lawyers asking people to

blame Avandia for their heart attack and inviting them to sue.”

“Drug litigation is **not** about trial lawyer profits,” says Brockovich. “Drug litigation is about empowering the tiny voice of the consumer against the fat cats of industry. Victims have a right to be heard. Victims have a right to have ‘megaphones’ so their voice can be heard; and trial lawyers are the personification of megaphones. . . . [articals that seek to curtail attorneys from advertising on the Internet] are trying to quell rights, and what is more shameful than that, especially in a free and ethical society?”

“Remember in the Wizard of Oz, how Dorothy announced herself? ‘I am Dorothy, the small and meek.’

“Come on people and take off the blinders! It is no coincidence that thousands on Avandia now have heart attacks. Don’t they have a right to be more than a petulant Dorothy trembling—and dying—at the feet of the Great and Powerful pharmaceutical companies?”

### Questions

1. What is Brockovich’s argument here? What/who is she for and against in advertising and why? Explain.
2. Do you agree or disagree with her arguments? Explain.

**SOURCES:** Frank, Ted (February 12, 2008). Avandia: Not So Harmful After All. *PointofLaw.com*, <http://www.pointoflaw.com/archives/2008/02/avandia-not-so-harmful-after-a.php>.

Brockovich, E. (February 14, 2008). Pros and Cons. *The Brockovich Report*, [http://www.brockovichblog.com/2008/02/pros\\_and\\_cons.html](http://www.brockovichblog.com/2008/02/pros_and_cons.html).

“[T]he government’s heretofore generally accepted power to regulate commercial speech in sensitive areas has been restricted.” Regulators have prohibited certain advertisements and product claims based on the government’s authority to protect public safety and the common good. The courts have sent the government (namely, the FDA) “back to the drawing board” to write disclaimers for claims it had argued to be inconclusive. The FDA’s regulatory power has currently been curtailed.<sup>32</sup>

### Paternalism, Manipulation, or Free Choice?

Moral responsibility between corporate advertisers and consumers can also be viewed along a continuum. At one end of a spectrum is *paternalistic control*; that is, “Big Brother” (the government, for example) regulates what consumers can and should hear and see. Too much protection can lead to arbitrary censorship and limit free choice. This is generally not desirable in a democratic market economy. At the other extreme of the continuum is *free choice* and *free speech* that are not regulated by any external government controls. Vulnerable groups—children, youth, the poor for example—may be more at risk from predatory advertisements, e.g., unregulated pornography and scam advertising. Between these extremes, corporations develop ads to both create and meet consumer demand to buy products and services. The moral and commercial control corporations have in this space can constrain free choice through researched ads that range between puffery, ambiguity, exaggeration, half truths, and deception to serve corporate interests. Ideally, corporations should seek to inform consumers fully and truthfully while using nonmanipulative, persuasive techniques to sell their products—assuming the products are safe and beneficial to consumer health and safety.

*Enforcement of advertising* can also be viewed along this continuum. Outright bans on ads can result in court decisions that determine a corporation’s right to free speech under the Constitution. At the other end of the spectrum, when actual harm and damage can be shown to have occurred as a result of and/or related to deceptive advertisements, the legal system intervenes. As moral and legal disputes occur over specific ads on the paternalism vs. manipulation continuum, debate also continues as a matter of perception and judgment from different stakeholder views. In the following section, specific controversial issues of advertising online, children and youth as targets of advertising, and tobacco and alcohol ads are discussed.

## 5.3 CONTROVERSIAL ISSUES IN ADVERTISING: THE INTERNET, CHILDREN, TOBACCO, AND ALCOHOL

### Advertising and the Internet

Advertising on the Internet and cell phones presents new opportunities and problems for consumers. The ubiquity of Internet and cell phone communication and advertising is evident from these growing indicators:

- 36% of U.S. consumers use cell phones for entertainment; 40% indicated that they watch TV shows online.



- Global online ad revenues will surpass \$60 billion by 2010.
- Mobile advertising totaled \$2.7 billion worldwide in 2007 and is predicted to reach \$4.6 billion in 2008 and \$19.1 billion by 2012. Internet advertising in the U.S. will reach \$25.9 billion in 2008.
- The U.S. online ad market will bring in \$35.4 billion in 2011.
- In Europe, online ad spending nearly doubled in 2006 to 8 billion euros. Out of 13 countries, the U.K. led in online ad money, with 39% of the total in Europe.
- Canada will have the highest compounded annual growth rate for online advertising of any country in the world, growing 23.5% each year for the next five years.
- Google, Yahoo, AOL, and MSN took in 57.4% of all U.S. Internet ad money in 2006, a percentage it predicts will rise to 66.6% for 2007.<sup>33</sup>

In addition, YouTube's advertising revenues for 2008 will range between \$70 million to \$200 million, representing 1% of Google's yearly revenue.<sup>34</sup> The social networking Web sites also draw large numbers of unique and returning viewers; for example, Facebook drew 115 million unique viewers in April 2008.<sup>35</sup> The ubiquity of ads on the Web causes ethical problems, particularly for parents and those who wish to protect youth from a host of mobile media instant access via cell phones and pop-up ads, and exposure to Web sites and advertisements dealing with sex, pornography, violence, drinking, and tobacco.

Pop-up and pop-under ads (ads that open up in a separate, full-browser window, underneath whatever site the user is viewing) are used on some of the most visited services.<sup>36</sup> Ethical Insight 5.3 illustrates how a pop-up ad led to an unusual but not atypical scam. In addition, marketers are turning to Web films to push their products through "byte-sized movies." In place of TV commercials that confront consumers with 30-second product introductions, the new "advertainment" shorts (also known as "commission content") present product or service information to the viewer through a story; Madonna starred in a BMW-funded film directed by her husband. "You're not using a product-based appeal, you're using an image-based appeal."<sup>37</sup>

Another ethical issue, as discussed in the first chapter, that was introduced through the Internet and pioneered by Napster is the blurring of boundaries between advertising and product sampling, which enables people to steal copyrighted songs, movies, and other information on the Web. "What do you tell 40 million kids who know how to turn a product into data that they can trade freely?"<sup>38</sup> Responses to this question from technology chief executives included the following: "You teach them some values. You can walk into any store and steal something, and kids don't do it. We've got to bring up a generation that understands that if you steal a movie over the Net, that is stealing." Another executive: "You've got to make it easier to do something legally than it is to do it illegally."<sup>39</sup> Although Napster was forced to change its online copyright violation practices, the ethical questions the technology and practice presented remain relevant areas of ethical inquiry. For example, Coles, Harris, and Davis state that:

## ETHICAL INSIGHT 5.3

## Internet Scam

Sarah-Lee Ryan, a 20-year-old journalism student in Hamilton, New Zealand was shocked to find that a cool half-million dollars had turned up in her bank account on May 24, 2008. Her surprise quickly turned to dismay, however, when bank officials froze the account and accused her of being the middleman in an attempted Internet money-laundering scam.

According to the *New Zealand Herald*, Ryan said that the episode began when she responded to an email from an online job search company asking for her account information. She complied with the site's request and the same day the scammers made a \$500,000 deposit into her account. As soon as the deposit was made, American Society of Banking (ASB) froze Ryan's account, and promptly sent an investigator to ask Ryan how the money got there.

The investigator, Ryan said, "was very abrupt with me implying I was

the 'middleman' in the scam . . . if I had spent any of it I would have been part of the laundering." Ryan speculated that online scammers deposited the money and were trying to use her, perhaps by asking her to take a percentage of the money and forward the bulk of it to unknown people. Ryan said if she had received such an email asking her to transfer the money, she would have informed the police immediately.

### Questions

1. Have you ever been part of a phishing or other Internet selling scam? Explain.
2. Do you believe self-regulatory practices are sufficient—without governmental regulation—to protect consumers? If not, what type of protection, and for whom do you believe it is necessary? Explain.
3. Which principle(s) was violated here: "Buyer beware," or "Seller take care"? Explain.

**SOURCE:** The New Zealand Herald (May 24, 2008). Hamilton student at centre of 500k internet scam. [http://www.nzherald.co.nz/section/1/story.cfm?c\\_id=1&objectid=10512262](http://www.nzherald.co.nz/section/1/story.cfm?c_id=1&objectid=10512262). Accessed July 23, 2008.

While music piracy is an ongoing, endemic problem for the "big 5," it is not yet clear whether MP3 users buy more or less music as a result of their online searches. In fact it has been suggested that there is some bad news for the industry in respect of its heavy-handed attempts to control music online with legal and technical measures, in the form of consumer resistance.<sup>40</sup> More recently then, questions have been raised as to how the Internet will develop now that music has become an integral part of online activities. The advent of portable MP3 players and their growing popularity, despite the early legal challenge, has encouraged a new wave of organizing CD collections and compiling personal playlists, while the popularity of Web radio is growing.<sup>41</sup>

The U.S. House of Representatives Judiciary Committee also passed the Internet Spyware Prevention Act of 2004, predicting that the problem of spyware would be solved. Personal and organizational computers have been

seriously disrupted by spyware software. This act carries penalties of up to five years in prison for using spyware that has also led to identity theft and gave the DOJ \$10 million to find ways to fight spyware and phishing—which is “the act of sending an e-mail to a user falsely claiming to be an established legitimate enterprise in an attempt to scam the user into surrendering private information that will be used for identity theft”<sup>42</sup>—without making phishing illegal.<sup>43</sup>

The debate continues over whether or not congressional legislation and laws can stop Internet spyware and spam. Critics of congressional action alone argue that both industries and government must work to end spam and spyware.<sup>44</sup> Europe, also involved in solving cybercrime, takes a wider stakeholder involvement approach that includes legal enforcement and educating industry representatives and consumers. The European Cybercrime Convention, sponsored by the Council of Europe, provides a treaty for combating global cybercrime. The cybercrime convention was approved by 30 countries, including Canada, Japan, South Africa, and the United States, and has been ratified by eight countries.<sup>45</sup>



**Figure 5.2**

### **How Serious, Really, Is Internet Spam, Spyware, & Crime?**

- There were 600 million Internet users in 2002 worldwide, double the 1999 number.
- In Germany, Internet crimes account for 1.3 percent of all recorded crimes, “but for 57%—or \$8.3 billion—of the material damage caused by crime.”
- A fast-rising crime worldwide is “phishing,” e-mails that appear to be from banks and other financial institutions asking consumers for their credit card details.
- A 2004 survey of 494 U.S. corporations found 20% had been subject to “attempts of computer sabotage and extortion, among others through denial of service attacks.”
- Web sites promoting racism, hatred and violence have risen by 300% since 2004. Most are hosted in the United States, but many may originate in Europe.
- Child pornography on the Internet is an industry worth approximately \$20 billion this year. “Surveys in 2003 suggest that child pornography accounts for 24% of image searches in peer-to-peer applications.”
- Organized crime is well established in cyberspace, using the Internet for human trafficking and committing economic crimes. In March, German police confiscated 19 Internet servers, 200 computers, 40,000 compact discs, and 38 terabytes of private videos and software that was for sale through the Internet. In April, searches across Europe netted illegal software, CDs, and DVDs valued at \$61.3 million.

**SOURCE:** Robert Wielaar, “Europe Council Looks to Fight Cybercrime,” BizReport, September 15, 2004, <http://www.bizreport.com/news/7981>

Again, the FTC has extensive guidelines for online advertising. For example, this governmental agency offers “Clear and Conspicuous Disclosures in Online Advertisements.” The following is only a sample from the FTC Web site:

When it comes to online ads, the basic principles of advertising law apply:

1. Advertising must be truthful and not misleading;
2. Advertisers must have evidence to back up their claims (“substantiation”); and
3. Advertisements cannot be unfair.<sup>46</sup>

The FTC’s Web site states that a particular disclosure is clear and conspicuous, under the following conditions:

- the placement of the disclosure in an advertisement and its proximity to the claim it is qualifying;
- the prominence of the disclosure;
- whether items in other parts of the advertisement distract attention from the disclosure;
- whether the advertisement is so lengthy that the disclosure needs to be repeated;
- whether disclosures in audio messages are presented in an adequate volume and cadence and visual disclosures appear for a sufficient duration; and
- whether the language of the disclosure is understandable to the intended audience.<sup>47</sup>

The following section presents specific advertisement issues in the areas of children and youth (as targets) and tobacco and alcohol.

## Advertising to Children

It is estimated that half of American children have a television in their bedroom, and “one study of third graders put the number at 70%. And a growing body of research shows strong associations between TV in the bedroom and numerous health and educational problems . . . . But in 2002, the journal *Pediatrics* reported that preschool children with bedroom TVs were more likely to be overweight.”<sup>48</sup> In addition to TV, at issue ethically is the unlimited availability of and exposure to explicit sexual, pornographic, and other questionable content on ads and Web sites, mixed with carefully crafted entertainment that is enhanced by new technologies. Should children and youth be able to log on from their computers, or from computers in libraries and cyber cafes, to Web sites showing explicit sexual and pornographic pictures and videos? The issue centers on how much government protection through censorship the public wants. Although AOL and other servers offer controls for parents, as do private firms through products such as CyberPatrol, CYBERSitter, and WebTrack, the issue remains one of principle: How much regulation interferes with free speech for all? Moreover, the file-sharing technology made popular by Napster provides additional opportunities not only for users to see explicit material, but to share the content instantly.

Also at issue are companies targeting children at too early an age—between eight and nine years old. The phenomenon known as **age compression**—KGOY (“kids getting older younger”) —refers to “twens/teens” (between childhood and teenage years). This market is targeted by such companies as Alberto-Culver, Estee Lauder, Procter & Gamble, and Unilever. The ‘tween’ market is estimated at between \$7 to 8.5 billion by 2012. Marketing strategies include products such as youth haircare, cosmetics, and skincare.<sup>49</sup> Children at this age are more vulnerable to persuasive techniques.<sup>50</sup> Rosalind Wiseman, the author of *Queen Bees & Wannabes* stated her opinion about the lack of responsibility of parents of children who are permitted to buy questionable products for their childrens’ ages, “Mothers and fathers do really crazy things with the best of intentions. I don’t care how it’s couched, if you’re permitting this [i.e. allowing the purchase of these products] with your daughter, you are hyper-sexualizing her. It’s one thing to have them play around with makeup at home within the bubble of the family. But once it shifts to another context, you are taking away the play and creating a consumer, and frankly, you run the risk of having one more person who feels she’s not good enough if she’s not buying the stuff.”<sup>51</sup>

European, Asian, African, and North American countries are addressing issues on advertising to children. The Children’s Online Privacy Protection Act (COPPA) and the FTC’s implementing rule took effect April 21, 2000. Commercial Web sites directed to children younger than thirteen years old or general audience sites that are collecting information from a child must obtain parental permission before collecting such information. The FTC also launched a special site at <http://www.ftc.gov/kidzprivacy> to help children, parents, and the operators understand the provisions of COPPA and how the law will affect them.<sup>52</sup> In 1974, CARU (Childrens’ Advertising Review Unit) of the National Advertising Division of the Council of Better Business Bureaus was created to develop guidelines for self-regulating children’s advertising (see <http://www.caru.org/guidelines/guidelines.pdf>). CARU approaches companies that violate COPPA (the Federal Children’s Online Privacy Protection Act). In May 2008, CARU recommended and received approval from the operator of the Web site [www.stardoll.com](http://www.stardoll.com), to “modify the site to assure it is in compliance with CARU’s guidelines and the federal Children’s Online Privacy Protection Act (COPPA).” CARU observed that the Stardoll Web site offered “a virtual world where visitors can design fashions for paper dolls and play other dress-up games.” When registering for basic membership on the site, visitors must first select one of the following two options: “12 year [sic] and under” or “13 year [sic] and under.” Potential members who clicked on the “12 year and under” link were asked to enter their gender and a user name, password, and e-mail address. Once that information was submitted, the next screen asked for a parent’s e-mail address.” After CARU requested changes to the Web site, Stardoll decided to implement a neutral age screening process and tracking mechanism.<sup>53</sup>

Advertising and media companies are also working with government agencies to change media strategies.<sup>54</sup> For example, the MMP (Media Monitoring Project) was created in South Africa because of increasing rates of obesity in children. The European Advertising Standards Alliance (EASA) and the European Sponsorship Association (ESA), also joined together in

January 2008 to form the Joint Arbitration Panel that will review “and adjudicate on consumer complaints about event sponsorship, an issue that is generally not covered in the ethical codes of most self-regulatory organisations (SROs) in Europe.”<sup>55</sup>

## Tobacco Advertising

Critics argue that tobacco and alcohol companies, in particular, continue to promote products that are dangerously unhealthy and that have effects that endanger others. According to the World Health Organization (WHO), cigarettes are “the only legal product that kills half of its regular users when consumed as intended by the manufacturer.”<sup>56</sup> “The World Health Organization (WHO) estimates the number of smokers in the world today at 1.3 million, and predicts that will rise to 1.7 million by 2025.”<sup>57</sup> The tobacco industry spent approximately \$8.2 billion in 1999 for traditional magazine direct-to-consumer advertising. Cigarette companies reportedly are targeting low-income women and minorities in their ads and focusing less on college-educated consumers. Three thousand new teenagers and youth begin smoking each day. One out of three is predicted to die from tobacco-related illnesses—several when they are middle-aged.<sup>58</sup>

The Marlboro man, the infamous and now defunct Old Joe Camel, and other cigarette brands linked adventure, fun, social acceptance, being “cool,” and risk-taking to smoking. Several new tobacco products are produced to entice youth and smokers. “[C]igarettes, smokeless tobacco, and cigars have been introduced in an array of candy, fruit, and alcohol flavors. R.J. Reynolds’ Camel cigarettes, for example, have come in more than a dozen flavors, including lime, coconut and pineapple, toffee, and mint. Flavorings mask the harshness of the products and make them appealing to children; new smokeless tobacco products have been marketed as ways to help smokers sustain their addiction in the growing number of places where they cannot smoke. In addition to traditional chewing and spit tobacco, smokeless tobacco now comes in teabag-like pouches and even in dissolvable, candy-like tablets . . . . New products and marketing have been aimed at women, girls and other populations. The most recent example is R.J. Reynolds’ Camel No. 9 cigarettes, a pink-hued version that one newspaper dubbed “Barbie Camel” because of marketing that appealed to girls.”<sup>59</sup>

## The Tobacco Controversy Continues

The tobacco controversy took yet another turn in 2004 when the DOJ brought the largest civil action against the tobacco industry, alleging that the industry defrauded and misled the public for 50 years regarding health risks of cigarette smoking. The DOJ requested \$280 billion from the industry to repay its “ill-gotten” profits.<sup>60</sup>

William Schultz, a former Justice Department lawyer, who helped develop the case, stated that, “What the government will argue is that the tobacco industry had a strategy to create doubt over health risks that made smokers more hesitant to quit, and those not smoking more likely to start. The fraud is that the companies knew about the health risks but created doubt and controversy about them to maintain their sales.”<sup>61</sup> The lawsuit

“has the potential to significantly transform the industry—forcing it to increase cigarette prices sharply, to change how it markets and promotes its product, and to spend billions for stop-smoking programs.”<sup>62</sup>

The U.S. Supreme Court ruled unanimously in June 2001 that states have no right to restrict outdoor tobacco advertising near schools and public parks. The ruling, a victory for tobacco companies, followed a Massachusetts case that prohibited tobacco ads within 1,000 feet of public parks, playgrounds, and schools.<sup>63</sup> The 2001 ruling raised questions regarding the topic of advertising and free speech, e.g., “Does a corporation have the same free speech rights under the First Amendment to purchase advertising as people have to air political, social, and artistic views? For most of the nation’s history, the Supreme Court has said that commercial speech (offering a product for sale) does not deserve the same protection as political speech.” In a series of cases from the Rehnquist Court, “. . . businesses were given powerful new First Amendment rights to advertise hazardous products.”<sup>64</sup> While the battle between antismoking and prosmoking stakeholders continues, the paramount issue for antismoking proponents ranges from a total ban on all tobacco products to this statement by Dan Smith, president of the American Cancer Society Cancer Action Network: “The future is a smoke-free country where in public places, you can go and it’s smoke free. I also think the future is much higher taxes on tobacco products.”<sup>65</sup>

## Alcohol Advertising

Alcohol is a form of substance abuse. Alcohol abuse is the third-leading cause of preventable death in the United States, taking \$186 billion from the national economy annually. For every 1,000 employees there are an estimated 44 problem drinkers; 127 employee family members who are problem drinkers; 34 lost work days from sickness, injury, and problem drinking annually; 219 work days of decreased productivity from alcohol use; 43 extra nights spent in the hospital by employees and their family members each year; and 32 extra emergency room visits by employees and their families each year.<sup>66</sup> Almost three million children have serious alcohol problems but less than 20% get the needed treatment. The Centers for Disease Control and Prevention report that:

Alcohol is the most commonly used and abused drug among youth in the United States, more than tobacco and illicit drugs. Although drinking by persons under the age of 21 is illegal, people aged 12 to 20 years drink 11% of all alcohol consumed in the United States. Over 90% of this alcohol is consumed in the form of binge drinking. On average, underage drinkers consume more drinks per drinking occasion than adult drinkers. In 2005, there were over 145,000 emergency room visits by youth aged 12 to 20 years for injuries and other conditions linked to alcohol.<sup>67</sup>

Alcohol ads also raise problems for consumers. Critics of alcohol ads argue that youths continue to be targeted as primary customers, enticed by suggestive messages linking drinking to popularity and success. Anheuser-Busch has been castigated for advertising its alcohol-heavy “Spykes—Liquid Lunchables”—which is a colorful, two-ounce container in “kid-friendly flavors like Spicy Mango, Hot Melons, Spicy Lime, and Hot Chocolate.” As the



## ETHICAL INSIGHT 5.4

**“Are Minors (Individuals under the Legal Drinking Age) Personally Responsible for Their Voluntary Choices? Should Minors Be Punished as Adults?”**

On November 13, 2003, Ayman Hakki filed a lawsuit in Washington, D.C., against several alcohol producers. The suit claimed that in an effort to create brand loyalty in the young, the defendants had deliberately targeted their television and magazine advertising campaigns at consumers under the legal drinking age for more than two decades.

Hakki asked for damages that included all of the profits the defendants had earned since 1982 from the sale

of alcohol to minors. He also sought class-action status for his suit. The plaintiff class consisted of all parents whose underage children had purchased alcohol in the last 21 years.

What is your opinion regarding the following quote?

“Suits against tobacco and alcohol companies for targeting youthful purchasers reflect a particular philosophy regarding people under the legal drinking or smoking age: they are too immature to take full responsibility for their actions. This philosophy is in serious tension with the approach that has increasingly come to dominate our society’s approach to juvenile criminal justice: when minors commit crimes, they ought to be held accountable and punished as adults.”

**SOURCE:** Colb, S. (December 3, 2003). A lawsuit against “big alcohol” for advertising to underage drinkers. FindLaw, <http://writ.news.findlaw.com/colb/20031203.html>.

watchdog consumer nonprofit Center for Science in the Public Interest (CSPI) noted about this drink, “these so-called Spykes aren’t juiceboxes, they’re malt liquor with more than twice the alcohol concentration of beer.”<sup>68</sup>

Product labeling and packaging are also two critical issues that are related to advertising. In a 2008 poll conducted by the Opinion Research Corporation, 1,003 Americans aged 21 and over were asked to identify the information that consumers consider most important on an alcohol label. The following results are reported:

- 77%: labels on products showing the alcohol content.
- 73%: the amount of alcohol shown in each serving.
- 65%: the calories shown in each serving.
- 57%: the carbohydrates in each serving.
- 52%: the amount of fat in each serving.

It was noted that “These findings reinforce a previous online survey conducted for *Shape Up America!* in December 2007, which reported that 79 percent of consumers would support alcohol labeling that summarizes the Dietary Guidelines’ advice.”<sup>69</sup>



## 5.4 MANAGING PRODUCT SAFETY AND LIABILITY RESPONSIBLY

Managing product safety should be priority number one for corporations. A sign in one engineering facility reads, “Get it right the first time or everyone pays!” Product quality, safety, and liability are interrelated topics, especially when products fail in the marketplace. As new technologies are used in product development, risks increase for users.

### How Safe Is Safe? The Ethics of Product Safety

Each year thousands of people die and millions are injured from the effects of smoking cigarettes, and using diet drugs, silicone breast implants, and consumer products such as toys, lawn mowers, appliances, power tools, and household chemicals, according to the Consumer Product Safety Commission. But how safe is safe? Few, if any, products are 100% safe. Adding the manufacturing costs to the sales price to bolster safety features would, in many instances, discourage price-sensitive consumers. Just as companies use utilitarian principles when developing products for markets, consumers use this logic when shopping. Risks are calculated by both manufacturer and consumer. However, enough serious instances of questionable product quality and lack of manufacturing precautions taken occur to warrant more than a simple utilitarian ethic for preventing and determining product safety for the consuming public. This is especially the case for commercial products such as air-, sea-, and spacecrafts, over which consumers have little, if any, control.

Are cigarettes safe products? “Cigarette smoking remains the leading cause of death and illness among Americans. Every year, roughly 438,000 Americans die from illnesses caused by tobacco use, accounting for one-fifth of all deaths. Tobacco use costs the nation about \$100 billion each year in direct medical expense and lost productivity.”<sup>70</sup>

Are other types of drugs safer than nicotine and additives in cigarettes? A “meta-analysis” (i.e., “the first comprehensive scientific review of both published studies and unpublished data that pharmaceutical companies have said they own and have the right to withhold”) by the British medical journal *The Lancet* found that “most antidepressants are ineffective and may actually be unsafe for children and adolescents.”<sup>71</sup> The study reported that youth, ages 5–18, should avoid certain antidepressants—Paxil, Zoloft, Effexor, and Celexa—because of the risk of suicidal behavior with no benefit from taking the drug. Prozac was found an effective drug for depressed children and had no increased suicide risk.<sup>72</sup> Doctors signed 232.7 million prescriptions for antidepressants in 2007, 25 million more than in 2003 and almost 13 million more than the next leading prescribed drug—i.e., cholesterol-managing lipid regulators.<sup>73</sup> It is interesting to note that, according to the study, the British government recommended against the use of most antidepressants for children, except for Prozac. The EU regulators recommended against Paxil being given to children. And the U.S. FDA requested drug manufacturers warn more strongly on their labels about possible links between the drugs taken by adolescents and “suicidal thoughts and behaviors.”

Consumers also value safety and will pay for safe products up to the point where, in their own estimation, the product's *marginal value equals its marginal cost*; that is, people put a price on their lives whether they are rollerblading, sunning, skydiving, drinking, overeating, or driving to work.<sup>74</sup>

**Product Safety Criteria: What Is the Value of a Human Life?** The National Commission on Product Safety (NCPS) notes that product risks should be reasonable. Unreasonable risks are those that could be prevented or that consumers would pay to prevent if they had the knowledge and choice, according to the NCPS. Three steps that firms can use to assess product safety from an ethical perspective follow:<sup>75</sup>

1. How much safety is technically attainable, and how can it be specifically obtained for this product or service?
2. What is the acceptable risk level for society, the consumer, and the government regarding this product?
3. Does the product meet societal and consumer standards?

These steps, of course, will not be the same for commercial aircraft as for tennis shoes.

Estimates regarding the monetary value of human life vary. As Ethical Insight 5.5 illustrates, a recent methodology estimates the value of a human life at \$129,000.

#### ETHICAL INSIGHT 5.5

### What Is the Value of a Human Life? \$129,000

Stanford economists Stefanos Zenios and his colleagues at the Stanford Graduate School of Business used kidney dialysis as a benchmark. Every year, dialysis saves the lives of hundreds of thousands of Americans who would otherwise die of renal failure while waiting for an organ transplant. It is also the one procedure that Medicare has covered unconditionally since 1972 despite rapid and sometimes expensive innovations in its administration. To tally the cost-effectiveness of such innovations, Zenios and his colleagues ran a computer analysis of more than half a million patients who underwent dialysis, adding up costs and compar-

ing that data to treatment outcomes. Considering both inflation and new technologies in dialysis, they arrived at \$129,000 as a more appropriate threshold for deciding coverage. "That means that if Medicare paid an additional \$129,000 to treat a group of patients, on average, group members would get one more quality-adjusted life year," Zenios says. Based on patient surveys, one "quality-tof-life" year is defined as about two years of life on dialysis.

Take the \$500,000 death benefit the government pays families when a soldier is killed in Iraq or Afghanistan. Or the cost calculations that for-profit health insurers make to determine how much coverage they'll give customers. In fact, at least some Americans seem at ease with allowing money to

(continued)

**(Continued)**

play a prominent role in health care decisions.

Their study showed that for the sickest patients, the average cost of an additional quality-of-life year was much higher—\$488,000. “It is difficult to justify the burden and expense of dialysis when persons have other serious health conditions such as, for example, advanced dementia or cancer,” says co-author Glenn Chertow, a nephrology professor at

the Stanford School of Medicine. “In these settings, dialysis is unlikely to provide any meaningful benefit.” But with organs including kidneys for transplant so scarce, is it justifiable to deny these patients a chance to live through dialysis? It is a question, Zenios says, that everyone should approach with trepidation. “What is the true value of a human life? That’s what we’re asking people,” he adds. “I wouldn’t pretend to know.”

**SOURCE:** Kingsbury, K. The value of a human life: \$129,000. (May. 20, 2008). *Time* and *CNN*, <http://www.time.com/time/health/article/0,8599,1808049,00.html>.

**Regulating Product Safety** Because of the number of product-related casualties and injuries annually and because of the growth of the consumer movement in the 1960s and 1970s, Congress passed the 1972 Consumer Product Safety Act, which created the Consumer Product Safety Commission (<http://www.cpsc.gov>). This is the federal agency empowered to protect the public from unreasonable risks of injury and death related to consumer product use. The five members of the commission are appointed by the president. The commission has regional offices across the country. It develops uniform safety standards for consumer products; assists industries in developing safety standards; researches possible product hazards; educates consumers about comparative product safety standards; encourages competitive pricing; and works to recall, repair, and ban dangerous products. Each year the commission targets potentially hazardous products and publishes a list with consumer warnings. It recently targeted Cosco for the faulty product design of children’s products. The death of an 11-month-old in July 1988 in a Cosco-designed crib was never reported by the company even though the company began to redesign the product. Cosco was forced to pay a record \$1.3 million in civil penalties to settle charges that it violated federal law by failing to report hundreds of injuries and the death.<sup>76</sup>

The CPSC is constrained in part by its enormous mission, limited resources, and critics who argue that the costs for maintaining the agency exceed the results and benefits it produces.

**Consumer Affairs Departments and Product Recalls** Many companies actively and responsibly monitor their customers’ satisfaction and safety concerns. A number of companies are using cellphone text messages to add more interactivity to their ads and consumer support. In addition, increased real-time mobile messaging, social networking services, Web browsing, and personal information management applications are being offered by some

companies like Microsoft to not only keep in touch with its customers but to also provide entertainment for them. Microsoft has teamed with Sony Ericsson Mobile Communications to give consumers more control over digital content.<sup>77</sup> Another way that companies can help consumers is by recalling their own products when defects are noticed.

Many companies aggressively and voluntarily recall defective products and parts when they discover them or are informed about them. Mattel recalled over 700,000 toys in 2007 because of lead paint issues. When unsafe products are not voluntarily recalled, the Environmental Protection Agency (EPA), National Highway Traffic Safety Administration (NHTSA), Food and Drug Administration (FDA), and Consumer Product Safety Commission (CPSC) have the authority to enforce recalls of known or suspected unsafe products. Recalled products are usually repaired. If not, the product or parts can be replaced or even taken out of service. American autos are frequently recalled for replacement and adjustment of defective parts.

Amitai Etzioni, a noted business ethicist, argues that:

There is, of course, no precise way of measuring how much more the public is willing to pay for a safer, healthier life via higher prices or taxes, or by indirect drag on economic growth and loss of jobs. In part this is because most Americans prefer to deal with these matters one at a time rather than get entangled with highly complex, emotion-laden general guidelines. In part it is also because the answer depends on changing economic conditions. Obviously, people are willing to buy more safety in prosperity than in recession.<sup>78</sup>

## Product Liability Doctrines

Who should pay for the effects of unsafe products, and how much should they pay? Who determines who is liable? What are the punitive and compensatory limits of product liability? The payout in 2001 in litigation and settlements in diet pill cases alone totaled \$7 billion. Merck settled its VIOXX case with a \$4.85 billion payout.<sup>79</sup> Also, 26 major companies have filed for bankruptcy court protection, and several others claim they have paid more than \$10 billion to settle asbestos liability-related lawsuits from products used in the 1970s.<sup>80</sup> The doctrine of product liability has evolved in the court system since 1916, when the dominant principle of *privity* was used. Until the decision in *Macpherson v. Buick Motor Company*, consumers injured by faulty products could sue and receive damages from a manufacturer if the manufacturer was judged to be negligent. Manufacturers were not held responsible if consumers purchased a hazardous product from a retailer or wholesaler.<sup>81</sup> In the *Macpherson* case, the defendant was ruled liable for harm done to Mr. Macpherson. A wheel on the car had cracked. Although Macpherson had bought the car from a retailer and although Buick had bought the wheel from a different manufacturer, Buick was charged with negligence. Even though Buick did not intend to deceive the client, the court ruled the company responsible for the finished product (the car) because—the jury claimed—it should have tested its component parts.<sup>82</sup> The doctrine of *negligence* in the area of product liability was thus established. The negligence doctrine means that all parties, including the manufacturer, wholesaler, distributor, and sales professionals, can be

held liable if reasonable care is not observed in producing and selling a product.

The doctrine of *strict liability* is an extension of the negligence standard. Strict liability holds that the manufacturer is liable for a person's injury or death if a product with a known or knowable defect goes to market. A consumer has to prove three things to win the suit: (1) an injury happened, (2) the injury resulted from a product defect, and (3) the defective product was delivered by the manufacturer being sued.<sup>83</sup>

*Absolute liability* is a further extension of the strict liability doctrine. Absolute liability was used in 1982 in the *Beshada v. Johns-Manville Corporation* case. Employees sued Manville for exposure to asbestos. The court ruled that the manufacturer was liable for not warning of product danger even though the danger was scientifically unknown at the time of the production and sale of the product.<sup>84</sup> Medical and chemical companies, in particular, whose products could produce harmful but unknowable side effects years later, would be held liable under this doctrine.

## Legal and Moral Limits of Product Liability

Product liability lawsuits have two broad purposes: First, they provide a level of compensation for injured parties, and second, they act to deter large corporations from negligently marketing dangerous products.<sup>85</sup> A California jury awarded Richard Boeken, a smoker who had lung cancer, a record \$3 billion in a suit filed against Philip Morris in 2001. In 2007, a Los Angeles judge ruled for Boeken's 15-year-old son on an issue related to his lawsuit against Philip Morris, which he argued was liable for the death of his father. The \$3 billion suit awarded earlier had been reduced to \$55 million. Boeken (age 57) died in January 2002, seven months after the verdict. The disease had spread to his spine and brain.<sup>86</sup> The legal and moral limits of product liability suits evolve historically and are, to a large degree, determined by political as well as legal stakeholder negotiations and settlements. Consumer advocates and stakeholders (for example, the Consumer Federation of America, the National Conference of State Legislators, the Conference of State Supreme Court Justices, and activist groups) lobby for strong liability doctrines and laws to protect consumers against powerful firms that seek profits over consumer safety. In contrast, advocates of product liability law reform (for example, corporate stockholders, Washington lobbyists for businesses and manufacturers, and the President's Council on Competitiveness) argue that liability laws in the United States have become too costly, routine, and arbitrary. They claim liability laws can inhibit companies' competitiveness and willingness to innovate. Also, insurance companies claim that all insurance-paying citizens are hurt by excessive liability laws that allow juries to award hundreds of millions of dollars in punitive damages because as a result, insurance rates rise.

However, a two-year study of product liability cases concluded that punitive damages are rarely awarded, more rarely paid, and often reduced after the trial.<sup>87</sup> The study, partly funded by the Roscoe Pound Foundation in Washington, D.C., is the most comprehensive effort to date to show the

patterns of punitive damages awards in product liability cases over the past 25 years. The results of the study are as follows:

1. Only 355 punitive damages verdicts were handed down by state and federal court juries during this period. One-fourth of those awards involved a single product—asbestos.
2. In the majority of the 276 cases with complete post-trial information available, punitive damages awards were abandoned or reduced by the judge or the appeals court.
3. The median punitive damages award for all product liability cases paid since 1965 was \$625,000—a little above the median compensatory damages award of \$500,100. Punitive damages awards were significantly larger than compensatory damages awards in only 25% of the cases.
4. The factors that led to significant awards—those that lawyers most frequently cited when interviewed or surveyed—were failure to reduce risk of a known danger and failure to warn consumers of those risks. A Cornell study reported similar findings.<sup>88</sup>

Also, an earlier federal study of product liability suits in five states showed that plaintiffs won less than 50% of the cases; a Rand Corporation study that surveyed 26,000 households nationwide found that only 1 in 10 of an estimated 23 million people injured each year thinks about suing; and the National Center for State Courts surveyed 13 state court systems from 1984 to 1989 and found that the 1991 increase in civil caseloads was for real-property rights cases, not suits involving accidents and injuries.<sup>89</sup>

Contrary to some expectations, another study found that “judges are more than three times as likely as juries to award punitive damages in the cases they hear.” Plaintiffs’ lawyers apparently mistakenly believe that juries are a soft touch, and “they route their worst cases to juries. But in the end, plaintiffs do no better before juries than they would have before a judge.” The study also found that the median punitive damages award made by judges (\$75,000) was nearly three times the median award made by juries (\$27,000).<sup>90</sup>

## Product Safety and the Road Ahead

As outsourcing practices continue and new technologies are increasingly used in products, problems for both corporations and consumers will persist. Corporations face issues of cutting costs and increasing quality to remain competitive, while at the same time sacrificing some control over their manufacturing processes through outsourcing. Consumers must trust corporations’ ability to deliver safe and healthy products, including food, drugs, toys, automobiles, and medical products. Consumer stakeholders must rely on government agencies such as the FDA and the CPSC (Consumer Product Safety Commission) to monitor and discipline corporations that violate basic safety standards and practices. Consumers can also use the many watchdog nonprofit groups that monitor and advise on the quality of different projects. *Consumer Reports* (ConsumerReports.org) is one such organization. Corporations must rely on state-of-the-art monitoring and safety programs in their respective industries—such as Six Sigma (<http://www.6-sigma.com>), ISO 9000 (a quality assurance program), and other Total Quality Management (TQM) programs.

## 5.5 CORPORATE RESPONSIBILITY AND THE ENVIRONMENT

There was a time when corporations used the environment as a free and unlimited resource. That time is ending, in terms of international public awareness and increasing legislative control. The magnitude of environmental abuse, not only by industries but also by human activities and nature's processes, has awakened an international awareness of the need to protect the environment. At risk is the most valuable stakeholder, the Earth itself. The depletion and destruction of air, water, and land are at stake. Consider the destruction of the rain forests in Brazil; the thinning of the ozone layer; climatic warming changes from carbon dioxide accumulations; the smog in Mexico City, Los Angeles, and New York City; the pollution of the seas, lakes, rivers, and groundwater as a result of toxic dumping; and the destruction of Florida's Everglades National Park. At the human level, environmental pollution and damage cause heart and respiratory diseases and skin cancer. The top environmental concerns include climate change; energy, water, biodiversity, and land use; chemicals (toxics and heavy metals); air pollution; waste management; and ozone layer depletion.<sup>91</sup>

We will preview and summarize some of the issues to indicate the ethical implications. The purpose here is not to present in great detail either the scientific evidence or all the arguments for these problems. Rather, our aim is to highlight some issues and suggest the significance for key constituencies from a stakeholder, issues management approach.

### Most Significant Environmental Problems

**Toxic Air Pollution** More people are killed, it is estimated, by air pollution (automobile exhaust and smokestack emissions) than by traffic crashes. The so-called greenhouse gases are composed of the pollutants carbon monoxide, ozone, and ultrafine particles called particulates. These pollutants are produced by the combustion of coal, gasoline, and fossil fuels in cars. In 2001, the American Lung Association ranked the following U.S. metropolitan areas the worst in terms of ozone and greenhouse pollution: Los Angeles and three other California sites, the Houston-Galveston area of Texas, and Atlanta. Another study stated that by adopting greenhouse gas abatement technologies that are currently available, 64,000 lives could be saved in Sao Paulo, Brazil; Mexico City, Mexico; Santiago, Chile; and New York City alone in the next 20 years. The same study estimated that 65,000 cases of chronic bronchitis could be avoided and almost 37 million days of lost work saved.<sup>92</sup>

Air pollution and greenhouse gases are linked to global warming, as evidenced in:

- The 5 degree increase in Arctic air temperatures, as the earth becomes warmer today than at any time in the past 125,000 years.
- The snowmelt in northern Alaska, which comes 40 days earlier than it did 40 years ago.
- The sea-level rise, which, coupled with the increased frequency and intensity of storms, could inundate coastal areas, raising groundwater salinity.
- The atmospheric CO<sub>2</sub> levels, which are 31% higher than preindustrial levels 250 years ago.<sup>93</sup>



Nationally, carbon dioxide emissions are a major source of air pollution. “America’s Top Five Warming Polluters (by Carbon Dioxide Emissions from Company-Owned or Operated Power Plants)” are listed in Figure 5.3. These companies had estimated annual CO<sub>2</sub> emissions of 70 million tons and reported 2003 revenues of \$4.4 billion.<sup>94</sup> Internationally, greenhouse gas emission statistics show that Spain had the largest increase in emissions, followed by Ireland, the United States, Japan, the Netherlands, Italy, and Denmark. The EU, Britain, and Germany had emission decreases during this period (Figure 5.4).

To stabilize the climate, global carbon emissions must be cut in half, from the current six billion tons a year to under three billion tons a year. This reduction can be accomplished by producing more efficient cars and power plants, using mass transit and alternative energy, and improving building and appliance standards. These changes would also help alleviate energy crises as well as global warming and air pollution.<sup>95</sup>

A *New York Times* article noted that, “In a striking shift in the way the administration of President George W. Bush has portrayed the science of climate change, a report (found on <http://www.climatescience.gov/>) to Congress focuses on federal research indicating that emissions of carbon dioxide and other heat-trapping gases are the only likely explanation for global warming over the last three decades.”<sup>96</sup> Attached to the report was a letter signed by Bush’s secretaries of energy and commerce and by his science adviser.

**Water Pollution and the Threat of Scarcity** “Approximately 1.1 billion people worldwide lack access to improved water sources, and 2.4 billion

Figure 5.3

### America’s Top Five Global Warming Polluters: By Carbon Dioxide Emissions from Company-Owned or Operated Power Plants

- #1: American Electric Power Company, Inc. (AEP)/American Electric Power Service Corp.
  - Estimated annual CO<sub>2</sub> emissions: 226 million tons
  - 2003 reported revenue: \$15.6 billion
- #2: The Southern Company (SO)
  - Estimated annual CO<sub>2</sub> emissions: 171 million tons
  - 2003 reported revenue: \$11.28 billion
- #3: Tennessee Valley Authority
  - Estimated annual CO<sub>2</sub> emissions: 110 million tons
  - 2003 reported revenue: \$6.95 billion
- #4: Xcel Energy Inc. (XEL)
  - Estimated annual CO<sub>2</sub> emissions: 75 million tons
  - 2003 reported revenue: \$7.9 billion
- #5: Cinergy Corp. (CIN)
  - Estimated annual CO<sub>2</sub> emissions: 70 million tons
  - 2003 reported revenue: \$4.4 billion

**SOURCE:** U.S. Embassy in Tokyo, “U.S. Releases Reports on Technologies to Reduce Greenhouse Gases,” December 3, 2003, <http://japan.usembassy.gov/e/p/tp-20031204-01.html>.



Figure 5.4

Greenhouse Gas Emissions: United States, Japan, and Selected EU Countries

	Reduction Target Increases by 2008–2012*	Emission Change 1990–1999
Spain	15.0%	23.2%
Ireland	13.0%	22.1%
United States	27.0%	16.0%
Japan	26.0%	7.8%
Netherlands	26.0%	6.1%
Italy	26.5%	4.4%
Denmark	221.0%	4.0%
European Union	28.0%	24.0%
Britain	212.5%	214.0%
Germany	221.0%	218.7%

\*Kyoto Protocol and E.U. burden sharing

**SOURCE:** European Commission: European Climate Network. Adapted from G. Winestock, “EU Wrestles with Business over Emissions,” *Wall Street Journal*, July 13, 2001, A9.

people lack access to any type of improved sanitation. This lack of access comes with a heavy price. Some 1.7 million deaths a year worldwide are attributable to unsafe water and to poor sanitation and hygiene, mainly through infectious diarrhea. Most of the deaths (90%) occur in children, and virtually all occur in developing countries. Every year, more than one million people die of malaria, a disease closely linked to the poor management of water resources, and about 6% of the global burden of disease is water related. Much of the morbidity and mortality could be mitigated by providing adequate sanitation services, a safe water supply, and hygiene education. These are effective interventions that studies suggest could reduce mortality from diarrheal disease by an average of 65% and related morbidity by 26%.”<sup>97</sup>

Water pollution is a result of industrial waste dumping, sewage drainage, and runoff of agricultural chemicals. The combined effects of global water pollution are causing a noticeable scarcity. Water reserves in major aquifers are decreasing by an estimated 200 trillion cubic meters each year. The problem stems from the depletion and pollution of the world’s groundwater. “In Bangladesh, for instance, perhaps half the country’s population is drinking groundwater containing unsafe levels of arsenic. By inadvertently poisoning groundwater, we may turn what is essentially a renewable resource into one that cannot be recharged or purified within human scales, rendering it unusable.”<sup>98</sup> It is estimated that the United States will have to spend \$1 trillion over the next 30 years to begin to

purify thousands of sites of polluted groundwater. An EPA report estimated that it could cost \$900 million to \$4.3 billion annually to implement one of the tools under the Clean Water Act for cleaning up the nation's waters.<sup>99</sup> It will require an integrated global effort of public and private groups, of individuals and corporations, to begin planning and implementing massive recycling, including agricultural, chemical, and other pollution controls to address water protection and control. Many companies have already begun conservation efforts. Xerox has halved its use of dichloromethane, a solvent used to make photoreceptors. The firm also reuses 97% of the solvent and will replace it with a nontoxic solvent. The Netherlands has a national goal of cutting wastes between 70 and 90%.

## Causes of Environmental Pollution

Some of the most pervasive factors that have contributed to the depletion of resources and damage to the environment are as follows:

1. *Consumer affluence.* Increased wealth—as measured by personal per capita income—has led to increased spending, consumption, and waste.
2. *Materialistic cultural values.* Values have evolved to emphasize consumption over conservation—a mentality that believes in “bigger is better,” “me first,” and a throwaway ethic.
3. *Urbanization.* Concentrations of people in cities increase pollution, as illustrated by Los Angeles, New York City, Mexico City, Sao Paulo, and Santiago, to name a few.
4. *Population explosion.* Population growth means more industrialization, product use, waste, and pollution.
5. *New and uncontrolled technologies.* Technologies are produced by firms that prioritize profits, convenience, and consumption over environmental protection. Although this belief system is changing, the environmental protection viewpoint is still not mainstream.
6. *Industrial activities.* Industrial activities that, as stated earlier, have emphasized depletion of natural resources and destructive uses of the environment for economic reasons have caused significant environmental decay.<sup>100</sup>

## Enforcement of Environmental Laws

A number of governmental regulatory agencies have been created to develop and enforce policies and laws to protect the general and workplace environments. The Occupational Safety and Health Administration (OSHA), the Consumer Product Safety Commission, the Environmental Protection Agency, and the Council on Environmental Quality (CEQ) are among the more active agencies that regulate environmental standards. The EPA, in particular, has been a leading organization in regulating environmental abuses by industrial firms.

In 1970, the EPA's mission and activities concentrated on controlling and decreasing toxic substances, radiation, air pollution, water pollution, solid waste (trash), and pesticides. The EPA has since used its regulatory powers to enforce several important environmental laws such as:

- *The Clean Air Act of 1970, 1977, 1989, and 1990*: The latest revision of this law includes provisions for regulating urban smog, greenhouse gas emissions, and acid rain and for slowing ozone reduction. Alternative fuels were promoted and companies were authorized to sell or transfer their right to pollute within same-state boundaries—before, pollution rights could be bought, sold, managed, and brokered like securities.
- *The Federal Water Pollution Control Act of 1972*: Revised in 1977, this law controls the discharge of toxic pollutants into the water.
- *The Safe Drinking Water Act of 1974 and 1996*: It established national standards for drinking water.
- *The Toxic Substances Control Act of 1976*: It created a national policy on regulating, controlling, and banning toxic chemicals where necessary.
- *The Resource Conservation and Recovery Act (RCRA) of 1976*: This legislation provides guidelines for the identification, control, and regulation of hazardous wastes by companies and state governments. The \$1.6 billion Superfund was created by Congress in 1980. It provides for the cleanup of chemical spills and toxic waste dumps. Chemical, petroleum, and oil firms' taxes help keep the Superfund going, along with U.S. Treasury funds and fees collected from pollution control. One in four U.S. residents lives within four miles of a Superfund site. It is estimated that 10,000 sites still need cleaning, and it may cost \$1 trillion and take 50 years to complete this work.<sup>101</sup>
- *Chemical Safety Information, Site Security, and Fuels Regulatory Relief Act of 1999*: It created standards for storing flammable fuels and chemicals.

## The Ethics of Ecology

Advocates of a new environmentalism argue that when the stakes approach the damage of the earth itself and human health and survival, the utilitarian ethic alone is an insufficient logic to justify continuing negligence and abuse of the earth. For example, Sagoff argues that cost-benefit analysis can measure only desires, not beliefs. In support of corporate environmental policies, he asks:

Why should we think economic efficiency is an important goal? Why should we take wants and preferences more seriously than beliefs and opinions? Why should we base public policy on the model of a market transaction rather than the model of a political debate? Economists as a rule do not recognize one other value, namely, justice or equality, and they speak, therefore, of a “trade-off” between efficiency and our aesthetic and moral values. What about the trade-off between efficiency and dignity, efficiency and self-respect, efficiency and the magnificence of our natural heritage, efficiency, and the quality of life?<sup>102</sup>

This line of reasoning raises questions such as these: What is a “fair market” price or replacement value for Lake Erie? The Atlantic Ocean? The Brazilian rainforest? The stratosphere?

Five arguments from those who advocate corporate social responsibility from an ecology-based organizational ethic include the following:

1. Organizations' responsibilities go beyond the production of goods and services at a profit.
2. These responsibilities involve helping to solve important social problems, especially those they have helped create.
3. Corporations have a broader constituency than stockholders alone.
4. Corporations have impacts that go beyond simple marketplace transactions.
5. Corporations serve a wider range of human values than just economics.<sup>103</sup>

Although these guidelines serve as an ethical basis for understanding corporate responsibility for the environment, utilitarian logic and cost-benefit methods will continue to play key roles in corporate decisions regarding their uses of the environment. Also, judges, courts, and juries will use cost-benefit analysis in trying to decide who should pay and how much when settling case-by-case environmental disputes. Some experts and industry spokespersons argue that the costs of further controlling pollutants such as smog outweigh the benefits. For example, it is estimated that the cost of controlling pollution in the United States has exceeded \$160 billion.<sup>104</sup> A World Health Organization study has estimated that air pollution will cause 8 million deaths worldwide by 2020. How many lives would justify spending \$160 billion annually? Although some benefits of controlling pollution have been identified, such as the drop in emissions, improvement of air and water quality, cleanup of many waste sites, and growth of industries and jobs related to pollution control (environmental products, tourism, fishing, and boating), it is not clear whether these benefits outweigh the costs.<sup>105</sup> One question sometimes asked regarding this issue is, Would the environment be better off *without* the environmental laws and protection agencies paid by tax dollars?

## Green Marketing, Environmental Justice, and Industrial Ecology

An innovative trend in new ecology ethical thinking is linking the concepts of green marketing, environmental justice, and industrial ecology.<sup>106</sup> Green marketing is the practice of “adopting resource conserving and environmentally-friendly strategies in all stages of the value chain.”<sup>107</sup> The green market was estimated at 52 million households in the United States in 1995. One study identified trends among consumers who would switch products to green brands: 88% of consumers surveyed in Germany said they would switch, as would 84% in Italy and 82% in Spain.<sup>108</sup> Companies are adopting green marketing as a competitive advantage and are also using green marketing in their operations: for example, packaging materials that are recyclable, pollution-free production processes, pesticide-free farming, and natural fertilizers.

Environmental justice is “the pursuit without discrimination based on race, ethnicity, and/or socioeconomic status concerning both the enforcement of existing environmental laws and regulations and the reformation of public health policy.”<sup>109</sup> Linking environmental justice to green marketing involves identifying companies that would qualify for visible, prestigious awards—such as

the Edison Award—for producing the best green products. To win the award, companies would demonstrate that they had, for example, (1) produced new products and product extensions that represented an important achievement in reducing environmental impact, (2) indicated where and how they had disposed of industrial and toxic materials, and (3) incorporated recycling and use of less toxic materials in their strategies and processes.

The green marketing and environmental justice link to industrial ecology is made in the long-range vision and practice of companies' integrating environmental justice into sustainable operational practices on an industry-wide basis. Industrial ecology is based on the principle of operating within nature's domain—that is, nothing is wasted; everything is recycled.

## **Rights of Future Generations and Right to a Livable Environment**

The ethical principles of rights and duties regarding the treatment of the environment and multiple stakeholders are (1) the rights of future generations and (2) the right to a livable environment. These rights are based on the responsibility that the present generation should bear regarding the preservation of the environment for future generations. In other words, how much of the environment can a present generation use or destroy to advance its own economic welfare? According to ethicist John Rawls, "Justice requires that we hand over to our immediate successors a world that is not in worse condition than the one we received from our ancestors."<sup>110</sup>

The right to a livable environment is an issue advanced by Blackstone.<sup>111</sup> The logic is that each human being has a moral and legal right to a decent, livable environment. This "environmental right" supersedes individuals' legal property rights and is based on the belief that human life is not possible without a livable environment. Therefore, laws must enforce the protection of the environment based on human survival. Several landmark laws have been passed, as noted earlier, that are based more on the logic related to Blackstone's "environmental right" than on a utilitarian ethic.

## **Recommendations to Managers**

Boards of directors, business leaders, managers, and professionals should ask four questions regarding their actual operations and responsibility toward the environment:

1. How much is your company really worth? (This question refers to the contingent liability a firm may have to assume depending on its practices.)
2. Have you made environmental risk analysis an integral part of your strategic planning process?
3. Does your information system "look out for" environmental problems?
4. Have you made it clear to your officers and employees that strict adherence to environmental safeguarding and sustainability requirements are a fundamental tenet of company policy?<sup>112</sup>

Using the answers to these questions, an organization can determine its stage on the corporate environmental responsibility profile (see Figure 5.5).

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The stages range from Beginner (who shows no involvement and minimal resource commitment to responsible environmental management) to Pro-activist (who is actively committed and involved in funding environmental management).

Finally, managers and professionals can determine whether their company's environmental values are reflected in these three ethical principles, quoted from the article "Toward a Life Centered Ethic for Business."<sup>113</sup>

*The Principle of Connectedness.* Human life is biologically dependent on other forms of life, and on ecosystems as a whole, including the non-living aspects of ecosystems. Therefore, humans must establish some connection with life and respect that it exists because living things exist in some state of cooperation and coexistence.

*The Principle of Ecologizing Values.* Life exists in part because of the ecologizing values of linkage, diversity, homeostatic succession, and community. There is a presumption that these values are primary goods to be conserved.

*The Principle of Limited Competition.* "You may compete (with other living beings) to the full extent of your abilities, but you may not hunt down your competitors or destroy their food or deny them access to food. You may compete but may not wage war."<sup>114</sup> [We would add to the last sentence, "without just cause."]

## CHAPTER SUMMARY

The ethical principles related to corporate responsibility toward consumers include: (1) the duty to inform consumers truthfully, (2) the duty not to misrepresent or withhold information, (3) the duty not to unreasonably force consumer choice or take undue advantage of consumers through fear or stress, and (4) the duty to take “due care” to prevent any foreseeable injuries. The use of a utilitarian ethic was discussed to show the problems in holding corporations accountable for product risks and injuries beyond their control. These principles continue to apply in contemporary advertising online, through cell phones, and media.

Businesses have legal and moral obligations to provide their consumers with safe products without using false advertising and without doing harm to the environment. The complexities and controversies with respect to this obligation stem from attempts to define “safety,” “truth in advertising,” and levels of “harm” caused to the environment. The Federal Trade Commission’s guidelines for online marketing show that this agency has considerable power and legitimacy in informing the public about ads; it also serves as a useful watchdog on corporate advertising and product regulation. Arguments for and against advertising were presented, with problematic examples of false advertising from the food and tobacco industries highlighted.

Product safety and liability were discussed through the doctrines of negligence, strict liability, and absolute liability. The Johns-Manville asbestos crisis was presented as an example. The legal and moral limits of product liability were summarized. Presently, states are moving to limit punitive damages in product liability cases, and tort reform is predicted to change the direction of product liability litigation toward more protection for manufacturers than for injured consumers.

Corporate responsibility toward the environment was presented by showing how air, water, and land pollution is a serious, long-term problem. Federal laws aimed at protecting the environment were summarized. Increasing concern over the destruction of the ozone layer, the destruction of the rain forests, and other environmental issues has presented firms with another area where economic and social responsibilities must be balanced. Innovative concepts and corporate attitude changes were discussed. Green marketing, environmental justice, and industrial ecology principles are being practiced by a growing number of corporations, particularly in Europe—especially since green products and clean manufacturing processes (and certifications) offer a competitive advantage. An innovative move by some corporations is to include environmental safety practices in the strategic, enterprise, and supply chain dimensions of industrial activities and practices. A diagnostic (Figure 5.4) enables a company to identify its stage of social responsibility toward the environment.

## QUESTIONS

1. What advertisements—and where do these appear (TV, Internet, print)—do you find “unethical” but legal? Explain.
2. What ethical principles of advertising apply to consumers in all cultures and countries? Explain.
3. Identify some problems associated with the free-market theory of corporate responsibility (discussed in Chapter 4) for consumers? Compare this view with the social contract and stakeholder perspectives (also discussed in Chapter 4) of corporate social responsibility.
4. Where does the liability of a company end and the responsibility of consumers begin for products? Explain your answer as you define this question more specifically.
5. What constitutes “unreasonable risk” concerning the safety of a product? Identify considerations that define the safety of a product from an ethical perspective.
6. Do you believe the environment is in trouble from climate change and global warming, or do you believe this is “hype” from the press and scientists? Explain.
7. Evaluate and comment on this statement: “The U.S., Europe, and North American countries have created waste, pollution, and environmental devastation for decades, even centuries; is it fair that countries like China and India should have the same sanctions now regarding their use of technologies, fuels, and other polluting devices as the U.S. and Europe?”

## EXERCISES

1. Identify a recent example of a corporation accused of false or deceitful advertising. How did it justify the claims made in its ad? Do you agree or disagree with the claims? Explain.
2. In a paragraph, explain your opinion of whether the advertising industry requires regulation.
3. Can you think of an instance when you or someone you know was affected by corporate negligence in terms of product safety standards? If so, did you or the person communicate the problem to the company? Was any action taken regarding the defective product? Explain.
4. Do you believe cigarette, cigar, and pipe smoking should be banned from all public places where passive smoking can affect nonsmokers? Explain. Use the following (or other) Web sites to argue your position: <http://www.cdc.gov>; <http://www.tobacco.org>; <http://www.thetruth.com>; <http://www.trytostop.org>; <http://www.cancer.org>; <http://www.getoutraged.com>.
5. Find a recent article discussing the environmental damage caused by a corporation’s activities. Recommend methods the firm in the article should employ to reduce harmful effects on the environment.
6. Find a recent article discussing an innovative way in which a corporation is helping the environment. Explain why the method is innovative and whether you believe the method will really help the environment or will only help the company promote its image as a good citizen.



## REAL-TIME ETHICAL DILEMMA (OR NOT?)



## The Dark Side of Social Networking

Last summer, the local CBS affiliate television station, News 8, aired a story about a Web site called BumFinder.com. The Web site solicited users who would spot people who appeared to be homeless and plug in their location coordinates using a Google Map. The station interviewed San Diego's most famous homeless advocate, Father Joe Carroll, who was filmed as he accessed the site and expressed outrage at its existence. In the television spot, the creator of the site remained anonymous, but responded in e-mails with the insistence that the site was only to help community residents stay safe and secure.

The site has since been taken down by its creator, 27-year-old San Diego native [and student entrepreneur] Brant Walker. It wasn't his first—and wouldn't be his last—brush with controversy online. A graduate of San Diego's Platt College with a Web design multimedia degree, Walker's first business was a Web site called FakeYourSpace.com, which sold counterfeit friends, using stock photos of models, to MySpace users looking to juice up their online posses.

When asked in a *Voice of San Diego* interview, "And what about the first successful site you launched, FakeYourSpace.com? That's no longer up either, is it? What was the motivation for that site?" Walker responded, "FakeYourSpace (also

bought by [venture capitalists]) was going to be the next big thing. I had already sold several thousand "Fake Friends" for a dollar apiece, when I received cease and desist letters from Fox Legal (Fox owns MySpace) demanding we shut it down. Apparently they weren't too happy with the idea of being able to buy popularity. I got the idea for FakeYourSpace.com while browsing through users' MySpace profiles and thinking of ways I could help the less popular users get better-looking friends."

Walker's latest venture seems a mixture of those two. It's an online forum called RottenNeighbor.com, and it allows residents of a neighborhood to complain about the noise, dogs, midnight habits, or lawn-mowing antics of the folks next door. Launched last summer, the site was first based entirely out of Walker's UTC apartment until a portion was purchased by Attenunit, a venture capital firm, and most of the work moved to Austin, Texas. Walker still makes part of his living with the site, but his day job is viral and internet marketing, delivering movie clips to cell phones.

### Questions

1. Has Brant Walker committed any crime in his online entrepreneurial ventures? Explain.
2. How would you describe Walker's "ethics" as an online entrepreneur?
3. How do your "business ethics" compare to Walker's? Explain

**SOURCE:** Bennett, K. (Saturday, May 17, 2008). The dark side of social networking: Questions for Brant Walker. *Voice of San Diego News*, <http://www.voiceofsandiego.org/articles/2008/05/17/news/walker051708.txt>

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## Case 15

### Facebook's Beacon: Marketer's Treasure or User's Nightmare?

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Social networking Web sites like Facebook and MySpace provide “access to the personal lives and tastes of the people in your circle, or at least as much as they’re willing to share.” In October 2007, approximately 83 million people visited the MySpace or Facebook Web sites, which was about half of the people who went online in that month. Also, statistics published by comScore Media Metrix reveal that 65% of Facebook users have a MySpace account. Facebook has approximately 68 million members as compared to 300 million for MySpace.

Introduced in February 2004 as a social networking site for Harvard University students, Facebook grew enormously—expanding to other college campuses and beyond. As of March 2008, over half of Facebook users are no longer attending college, and people 25 years of age and older represent the fastest growing membership segment. Many of the adult users prefer more control over how personal details are shared. “For instance, a user might want to share an online album of party photos with a few close colleagues but not with others.” Additionally, “more businesses and corporate folks are joining Facebook.”

Developing applications and providing storage space for members’ information on a social networking site costs a lot of money. If a site like “Facebook can’t take in money from its users, it has to squeeze money from advertisers. And guess what? Advertisers expect bang for their bucks.” Moreover, with all sorts of people now joining social networking Web sites, “there’s starting to be real money in the business, as every major consumer advertiser realizes that if you can engage effectively with these

newly networked hordes, they become agents of your brand.”

In early November 2007, “both Facebook and MySpace announced new schemes that would allow advertisers to target messages more closely. The idea is that if ads are made more relevant, more people will click on them, which in turn will boost the fees the sites can charge for them.”

**Enter Beacon** Facebook’s advertising scheme is called “Beacon,” and “tracks members’ purchases and activities anywhere on the Web,” allowing them to be broadcast to the users’ friends. “For instance, Facebook users could receive messages telling them that a friend had bought a sweater on Overstock.com or a movie ticket on Fandango.com.” When it was introduced, Facebook’s explanation for Beacon sounded innocent enough. Chamath Paliapitiya, Facebook’s VP of product marketing and operations, said, “All we’re trying to do is make sure anytime there is a trusted word-of-mouth referral that your friend has made about this product, we share that information with you.” However, Beacon also enabled the incorporation of “commercial conversation into the social network to which Facebook can sell and attach advertising. If a user purchases a pair of Nike running shoes and Beacon alerts his or her friends, Nike could buy an ad to run alongside that alert that would include a link to a Web site—a ‘social ad,’ if you will.” Mark Zuckerberg, Facebook’s founder and CEO, said Beacon “was intended to give advertisers a way into the conversations between people,” but critics say that Beacon basically paved “the way for marketers to snoop directly into users’ personal pages.”

Beacon was designed to provide the bang that marketers wanted from their advertising dollars. "[T]here isn't an advertiser in America that isn't drooling over the prospect of getting access to the wealth of highly personal detail in an application like Facebook." Being able to pinpoint precisely the likes and dislikes of millions and millions of people is a marketers' dream come true.

Almost immediately, Facebook subscribers began complaining about invasions of privacy. Facebook "users rebelled and privacy watchdogs cried foul." Facebook attempted to defend Beacon, invoking Palihapitiya's argument that Beacon simply permitted the sharing of trusted word-of-mouth referrals. Users complained that Facebook "was exploiting for commercial purposes personal information members hadn't intended to share." Facebook users admit they want other people to know about their lives and activities, and are willing to trade privacy for increased connectedness; however, they want to do it on their own terms. Users say, "This isn't about the information Beacon collects, but how it collects it—peeking in on us, then asking to report to our friends what it saw. Beacon asks Facebook users to make ever more invasive trades for the sake of an ever more superficial sense of closeness."

Ironically, MoveOn.org created a Facebook group that opposed Beacon and sought signers for a petition entitled *Facebook, stop invading my privacy!* Within a short period of time 50,000 Facebook users who found Beacon "to be a breach of privacy and the implicit agreement between themselves and Facebook" signed the petition. Interestingly and perhaps surprisingly, petition signers "included users from ad agencies Ogilvy and DDB, Facebook investor Microsoft, and a marketer at a major package-goods company." Vauhini Vara, a reporter for the *Wall Street Journal*, says he conducted a highly unscientific poll of readers where he asked: "If Facebook could tell your friends what you do on other sites—buying movie tickets, clothes, etc.—when would you want to share that information?" Of 200

people who responded, "1.5% chose always, 30.5% chose often, sometimes or rarely, and 68% chose never." In the January 2008 issue of *Customer Relationship Management*, a ChoiceStream Personalization Survey reported that "although 66.6 percent of consumers expressed concerns about their privacy, 76 percent wanted some form of personalized content and 34 percent were willing to let sites track their behavior."

Under increasing user and public pressure, Facebook addressed the privacy problems with Beacon in short order. In early December 2007, Facebook's CEO, Mark Zuckerberg, wrote in a Facebook blog: "We've made a lot of mistakes building this feature, but we've made even more with how we've handled them. We simply did a bad job with this release, and I apologize for it." Although some Beacon users fear the site will become a massive direct-mail campaign, Zuckerberg sees it as just another form of word-of-mouth recommendation from a friend. Nonetheless, Facebook users can now adjust their privacy settings to opt out of the Beacon program entirely. Still, Facebook is "betting that for the bare-it-all generation growing up on social networks, broadcasting what you buy will seem as natural as posting the details of a bitter breakup—or what you ate for breakfast."

As expected, privacy advocates disagree with Zuckerberg's optimistic—and perhaps somewhat cavalier—outlook. Abbey Klaassen, writing in *Advertising Age*, maintains that "Facebook's Beacon travails are a lesson in the obvious: that advertising and user interests are often at odds. And in this case, it's not just Facebook's reputation that can be damaged by the perceived breach of trust but the involved marketers' as well." Linda Musthaler, writing in *Network World*, says, "There's just one catch. Just because people who pay you to help you provide a service want access to all that personal information that you collect, that doesn't make it right. Facebook ads and Beacon started us down a slippery slope, and no one knows how far it is to the bottom."

## Marketers versus Users: An Escalating Tension or a Resolvable Dilemma?

"Advertisers typically pay a premium for targeted ads that reach users who are likely to be most interested in their product or service." That is the fundamental marketing appeal of Beacon, and "a key to Facebook's effort to increase its advertising revenue, pegged at slightly more than \$150 million in 2007." Although Facebook had only a very small portion of the total Internet advertising revenues of about \$20 billion in 2007—which is about one-third the amount marketers spend on national broadcast and cable television—Beacon could provide the means for significant growth in Facebook's advertising revenue. Moreover, the Veronis Suhler Stevenson investment bank predicts "that Internet ad spending will reach \$62 billion in 2011, surpassing newspapers as the largest advertising medium." Clearly, Facebook will be vying for its chunk of the tripling Internet advertising revenues.

"As Facebook continues its attempts to take targeted and vital marketing to the next level, marketing may get more invasive, signaling the imminent need to confront security issues across the entire Web." "Activists' calls to regulate interactive advertising—which include the banning of behaviorally targeted ads—would, if followed, shut down this flow of advertiser money and the services for which it pays by limiting the medium's effectiveness." David Weinberger, a fellow at the Berkman Center for Internet & Society, says, "[A]fter having integrated itself into people's lives, Facebook has a responsibility to protect its tens of millions of users." On the other hand, Heidi Gautschi, writing in *EContent*, poses the question: "If you're not worried about sharing intimate information over the Web publicly, why would you be threatened by companies collecting some of your personal information?" Or as Randall Rothenberg, a reporter for the *Wall Street Journal*, points out, "Internet consumers have shown themselves willing and able to police the medium on their own. Just ask

Facebook: Consumer regulation proved itself to be a far more effective, efficient, economically productive and unforgiving mechanism than federal regulation ever will be."

## Questions for Discussion

1. Why do social networking Web sites appeal to so many people? What are people gaining and sacrificing by using social networking Web sites?
2. What ethical issues does Beacon raise for Facebook and its various stakeholders?
3. Do you support Mark Zuckerberg's position that Beacon is merely a natural technological extension of word-of-mouth referrals, or the Facebook critics' position that Beacon is an unwarranted commercialized invasion of privacy? Explain your position.
4. In your view, how, if at all, can the battle between Facebook advertisers and Facebook users be resolved?

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## Case 16

### Genetic Discrimination

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Genetic discrimination is defined by the Centers for Disease Control and Prevention as “prejudice against those who have or are likely to develop an inherited disorder.” Advances in science make possible the determination of whether specific gene mutations exist, and the ability to discover the likelihood of an individual developing a disorder based on the existence of these mutations. These developments have created situations that concern the public: their privacy and possible employment livelihood. One of the major issues noted by the National Human Genome Research Institute (NHGRI) is the possibility that individuals who have taken this testing, and received positive results, will be turned down for health insurance or employment. This possibility will most probably be at issue depending on the political party and dominant political persuasion in power nationally and at the state levels, as well as with the Supreme Court.

Many people with family histories or other factors that determine their susceptibility to certain diseases or disorders will have to make a decision about whether to be tested for the existence of certain genetic sequences or mutations. A major factor in this decision will be how this information will be used and who will be able to access the results. Patients may choose to refuse testing that could save their lives or improve their quality of life because they fear future discrimination. Employers with group insurance plans may want to know whether any of their employees are predisposed to a specific disorder. Insurance providers would also like to have the results of genetic testing to assist in underwriting policies. Both of these scenarios are likely to lead to discrimination against or exclusion of certain individuals for either employment or insurance coverage.

**Human Genome Project** One of the major catalysts of the advancement of genetic testing and the interpretability of genetic information was the Human Genome Project. The Human Genome Project began in 1990 as a joint effort between the National Institutes of Health and the United States Department of Energy. The project had six goals: (1) to identify all the approximately 20,000–25,000 genes in human DNA; (2) to determine the sequence of the 3 billion chemical base pairs that make up human DNA; (3) to store this information in databases; (4) to improve tools for data analysis; (5) to transfer related technologies to the private sector; and (6) to address the ethical, legal, and social issues (ELSI) that may arise from the project. In addition to helping meet these goals, accomplishments leading to the project’s completion in 2003 have also contributed to major advances in scientific research and health care, primarily in the areas of medicine and genetic testing. Understanding the genes and sequences associated with common diseases has future implications for the entire human population, and will help to detect and possibly remedy disorders with more precise and targeted treatments.

**Business Response to Advances in Genetic Testing and the Human Genome Project** Even before the entire human genome had been sequenced and published, and the implications of the discovery had been reviewed to establish guidelines and boundaries, biotechnology companies and others conducting scientific research had begun to develop uses for this new way of looking at human conditions and diseases. One question from this new branch of medical technology is who, if anyone, should own gene sequences and who has the rights to one’s genetic information? The issue of

patenting gene sequences began long before the map of the human genome was completed and prior to consequences of granting these patents were able to be seriously examined. Companies had already begun to submit applications and receive approval for gene sequences that had some still unknown future use and potential profitability. According to *Modern Drug Discovery* contributor, Charles W. Schmidt, "[T]hose who seek patents usually want to protect research investments in one of two markets: gene- and protein-based drug development or diagnostic testing that searches for gene sequences linked to a given illness." Even without strong federal regulations to guide the use and ownership of test data and eliminate the reluctance of people to agree to testing, companies developing genetic tests believed that patenting is necessary to protect an industry that is someday likely to generate millions in profits. Those in opposition to this view have trouble allowing ownership of something that is so personal. The major caveat to granting these patents is that it limits and slows the competition in the industry to find uses for and make advances in an already patented gene sequence. However, if there is no guarantee of exclusive ownership as the outcome of research, companies may choose not to move forward in research. The main issue of a significant business response to scientific advancements in genetic testing and gene sequencing is ensuring that laws and regulations keep up with technology and medical advances to prevent major abuse, ownership, and privacy issues.

**The Burlington Northern and Santa Fe Railroad Case** In February 2001 the Equal Employment Opportunity Commission (EEOC) filed a suit against the Burlington Northern and Santa Fe Railroad for secretly testing some of its employees. The genetic tests conducted had been developed by Athena Diagnostics in Worcester, Massachusetts, to detect a rare neuromuscular disorder, but Burlington

Northern had been using them to validate and predict claims of carpal tunnel syndrome made by railroad workers. This incident, and others like it across the United States and Europe over the following years, raised concerns about the access and rights that employers have to their employees' medical and genetic information. In this case, if Burlington Northern had discovered that employees with carpal tunnel syndrome had a genetic predisposition to the injury, the company could have claimed that the ailment was not job related and therefore denied payment of any medical bills. The EEOC filed its suit referencing the American Disabilities Act's statement that "it is unlawful to conduct genetic testing with the intent to discriminate in the workplace." Cases like this alerted lawmakers and activists to the growing concerns of discrimination in the workplace based on genetic information, and upon closer examination of the issue, revealed significant inconsistencies and gaps in the laws currently protecting the rights of employees.

**Government Response to Advances in Genetic Testing and Discrimination** As with most human resource issues, companies cannot always be trusted to act in the best interests of their individual employees, especially where privacy rights are concerned. Throughout the past two decades, the United States has drafted and passed several laws addressing the issue of discrimination by employers and private businesses, and protecting employees who speak out against discriminatory behavior. One of the most well-known regulations in this category is the Americans with Disabilities Act of 1990 (ADA), which prohibits discrimination in hiring on the basis of a disability. Similarly, Title VII of the Civil Rights Act of 1974 prohibits employment discrimination on the basis of race, color, religion, sex, and national origin. According to National Institutes of Health Consultant Robert B. Lanman, J.D., who was commissioned in May 2005 by the Secretary's



Advisory Committee on Genetics, Health, and Society to examine the adequacy of current laws protecting against genetic discrimination, these laws have not been updated to specifically relate to genetic discrimination. They offer protection to the extent that a genetic predisposition is common in a specific race or other group protected under the ADA or Civil Rights Act. In his executive summary, Lanman offered the example of Tay-Sachs disease, which is prevalent in persons of Eastern European Jewish ethnicity. Discrimination based on the genetic information of an individual that is unrelated to an individual's race or ethnicity would not currently fall under the protection of the ADA or Civil Rights Act.

A major section of the pieced-together legislation that is currently protecting citizens from genetic discrimination is the Health Insurance Portability and Accountability Act of 1996 (HIPAA). This act prohibits insurance companies from (1) excluding members because of a preexisting condition that is based solely on the results of genetic testing or family history, (2) imposing eligibility requirements, or (3) restricting coverage based on genetic information. HIPAA does not restrict insurance companies from "requesting, purchasing, or otherwise obtaining genetic information about an individual," and it does not restrict insurance companies from charging higher premiums or including this genetic information in the underwriting process.

The major problem with the state and federal regulations enacted to date is that genetic information is either not mentioned as a basis for discrimination, or it is not defined consistently throughout existing laws. The United States has two primary concerns: protecting the privacy of genetic information, and preventing discrimination based on genetic information—especially by employers and insurance companies. To address this issue, new federal regulation must cover gaps left in existing directives and account for future developments in the industry. The hodgepodge of existing

laws combined with the inconsistency of state laws leaves too many loopholes to provide comprehensive protection for the general public.

### **The Genetic Information Nondiscrimination Act of 2005**

On February 17, 2005, the Senate passed S.306, the "Genetic Information Nondiscrimination Act of 2005" with a vote of 98–0. The law was then passed on to the House of Representatives on March 10, 2005, where it was referred to the Subcommittee on Health. No further action has been taken, and the bill has not yet become a law. The proposed bill specifically "prohibits discrimination on the basis of genetic information with respect to health insurance and employment." In addition, it amends the Employee Retirement Income Security Act of 1974 (ERISA) and the Public Health Service Act (PHSA) to include in their definitions of genetic information any results of genetic testing and information pertaining to whether or not testing was performed. It will also disallow insurance companies from adjusting premiums based on the results of genetic testing, and prevents them from requiring genetic tests for subscribers or their dependants. The law concludes by covering fines and penalties and calls for a commission to review advances in science and technology and developments in genetic testing six years after the enactment of the law to make recommendations and amendments.

One of the possible reasons for not yet signing the Genetic Information Nondiscrimination Act is resistance from the Health Insurance Association of America (HIAA), and the claim that additional federal regulation is not needed. Opponents of the bill see sufficient restrictions in the current existing laws, and do not see the necessity of new legislation. However, Lanman's report, "An Analysis of the Adequacy of Current Law in Protecting Against Genetic Discrimination in Health Insurance and Employment," points out several shortcomings in the combined efforts to protect individuals from this type of



discrimination. More importantly, future advances in bio- and medical technology need to be accounted for—and somewhat are—by this new proposed bill.

The bill's consequences for employers and health insurance providers are focused around the idea of being informed. Since health insurance costs are rising, and they are likely to continue to rise due to advances in medicine, testing, and the ability to prolong life, employers must be more aware of the costs of hiring additional employees. Health insurance providers also must remain competitive in balancing the cost of providing health care coverage and mitigating the financial risk to themselves. If employers and health insurance providers are not privy to all of the information available concerning the insured parties, premiums will not be fair or balanced.

While the health insurance companies will probably not come out ahead in this battle, some of their concerns should be taken into consideration if the bill is to be amended before it is passed. For example, one of the members of the Human Genome Project's Committee for Ethical, Legal, and Social Implications, Nancy L. Fisher, MD, asks if genetic testing and health insurance can coexist. Fisher's main concern is the definition of terms like "preexisting condition" and "genetic information," and how new laws will affect not only the health insurance industry, and its ability to survive, but also the financial cost for taxpayers if "society decides that everyone is entitled to comprehensive health care."

**May 21, 2008: The Genetic Information Nondiscrimination Act** The Genetic Information Nondiscrimination Act (GINA), referred to as "the first civil rights legislation of the 21st century" became a law on May 21, 2008. The law prevents employers and insurers from using genetic data against individuals and employees. The law states that (1) employers cannot deny a person a job because s/he is genetically predisposed to develop a

particular disease or condition; (2) insurers cannot use an individual's genetic profile to deny coverage or raise his/her premiums; and (3) now protected, an individual benefits from medical genetic testing without concern with regard to results being used against him/her. However, the law does not protect third parties from using an individual's genetic results, including the military. It is also plausible that an individual may still be at risk of being discriminated against with regard to health insurance.

### Questions for Discussion

1. What is genetic discrimination, and why is it an issue?
2. Who would benefit and who would be at risk if genetic testing and the results of such tests were legal and could be required of employees? Explain.
3. Explain the ethical principle(s) that could be used to (a) argue against genetic testing of employees and (b) argue for genetic testing.
4. Explain your position on the issue of genetic testing by employers.

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This case was written by Jaclyn Publi-cover, Bentley College, under the direction of Joseph W. Weiss, for classroom discussion, and not for any type of official or unofficial decision making by personnel or management. Sources cited and used in the case are in the public domain. This case was developed from material contained in the following sources:

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## NOTES

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# 6

## THE CORPORATION AND INTERNAL STAKEHOLDERS

### Values-Based Moral Leadership, Culture, Strategy, and Self-Regulation

#### 6.1 Leadership and Stakeholder Management

Ethical Insight 6.1

#### 6.2 Organizational Culture, Compliance, and Stakeholder Management

#### 6.3 Leading and Managing Strategy and Structure

#### 6.4 Leading and Balancing Internal Stakeholder Values in the Organization

#### 6.5 Corporate Self-Regulation and Ethics Programs: Challenges and Issues

##### Chapter Summary

##### End-of-Chapter Questions and Exercises

##### Real-Time Ethical Dilemmas

##### Cases

Commitments to Sustainability in the  
Oil and Gas Industry

What's Written vs What's Reality

### OPENING CASE

"[Warren] Buffett has taken unprecedented steps in recent years to ensure that his messages about investing, ethics, and philanthropy reach an audience that will survive him. He didn't invent the light bulb, but he's had lots of bright ideas. He didn't devise the mass-production assembly line, but his companies have sold masses of goods. And Warren Buffett didn't originate the concept of money, but he has more of it than anyone else. So what will be the Omaha investor's legacy? Or,

rather, his legacies? Observers say the 77-year-old's ideas and philosophy of business and life will last far beyond his own. Buffett has taken unprecedented steps in recent years to ensure that his messages about investing, ethics and philanthropy reach an audience that will survive him. 'Somebody from this group will learn something that will affect their lives,' Buffett told a group of graduate students during a 2005 visit to Omaha. 'Buffett's emphasis on working with ethical people is already influencing

business leaders and business schools, a change that could last far into the future,' said Bruce Avolio, director of the University of Nebraska-Lincoln's Leadership Institute. 'He buys the culture when he invests in an organization,' Avolio said, 'valuing a business's human condition as much as its financial condition. That's shifting people's thinking, and it has a huge impact. It's a model that's replicable—treating people fairly. Integrity underlies not only Warren Buffett's investments but also his philosophy of life.' Keith Darcy, head of the 1,400-member Ethics & Compliance Officers Association in Waltham, MA, said Buffett has played a hand in 'a flight to integrity' by investors, executives, employees, suppliers, and customers who want to be involved with companies that do business correctly. 'It's essential to him to be working with people he trusts,' Darcy said, 'Without that level of trust, it's not worth doing business.

Certainly he has been an exemplar for understanding that when you make investments, character and reputation are everything.' In meetings with students, Darcy said, Buffett 'speaks from his heart. He certainly is a mythological figure, except he's not a myth, he's real—a man of enormous success who always has believed in investing in companies with inherent value, but in particular the people in those businesses.' Darcy believes Buffett will be a role model far into the future. Buffett states: 'I want employees to ask themselves whether they are willing to have any contemplated act appear on the front page of their local paper the next day, to be read by their spouses, children, and friends . . . If they follow this test, they need not fear my other message to them: Lose money for the firm, and I will be understanding; lose a shred of reputation for the firm, and I will be ruthless.'"<sup>1</sup>

## 6.1 LEADERSHIP AND STAKEHOLDER MANAGEMENT

Leaders influence others to follow an organization's vision, mission, and strategies, and to achieve goals.<sup>2</sup> Leaders also help define the culture and values of organizations which are essential for setting and modeling the legal and ethical tone and boundaries. Warren Buffett, founder and CEO of Berkshire Hathaway, embodies the ethical leadership this chapter addresses.

The CEO (chief executive officer) or president, who sometimes is also the chair of the board of directors, is the highest ranking leader in a company. However, in both for- and not-for-profit organizations, the CEO reports to and is advised by the board of directors, which also serves leadership and governance roles. Leadership is not only limited to a few individuals or teams at the top of organizations. Individuals throughout an organization exert leadership responsibilities and influence in their roles and relationships to direct and guide their organizations. As you read this chapter, envision yourself as a potential or evolving leader—or as a leader you are or were.

Leadership also requires active involvement in internal and external stakeholder relationships. Business relationships involve transactions and decisions that require ethical choices and, many times, moral courage. Building new strategic partnerships, transformational restructuring and layoffs, consumer lawsuits, environmental crises, bold new "green" initiatives, and turning around corporate cultures damaged by the effects of harmful products are examples of situations that require leadership

business and ethical decisions. Leaders are responsible for the economic success of their enterprises and for the rights of those served inside and outside their boundaries. Research on leadership demonstrates that moral values, courage, and credibility are essential leadership capabilities.<sup>3</sup> James Collins' five-year research project on "good to great" companies found that leaders who moved from "good to great" showed what he called "Level 5" leadership. These leaders "channel their ego needs away from themselves and into the larger goal of building a great company. It's not that Level 5 leaders have no ego or self-interest. Indeed, they are incredibly ambitious—but *their ambition is first and foremost for the institution, not themselves.*"<sup>4</sup> Collins also concluded that Level 5 leaders build "enduring greatness through a paradoxical blend of personal humility and professional will."<sup>5</sup>

This chapter focuses on the challenges that values-based leaders face while managing internal stakeholders, strategy, and culture in organizations. From a stakeholder management approach, an organization's leaders are responsible for initiating and sustaining an ethical, principled, and collaborative orientation toward those served by the firm.<sup>6</sup> Leaders model and enforce the values they wish their companies to embody with stakeholders.<sup>7</sup> One of an organization's most prized assets is its reputation, as noted earlier in the text. Reputations are built through productive and conscientious relationships with stockholders and stakeholders.<sup>8</sup>

A stakeholder, values-based leadership approach determines whether or not the organization and culture:

- Are integrated or fragmented.
- Tolerate or build relationships.
- Isolate the organization or create mutual benefits and opportunities.
- Develop and sustain short-term or long-term goals and relationships.
- Encourage idiosyncratic dependent implementation based on division, function, business structure, and personal interest and style or encourage coherent approaches, driven by enterprise, visions, missions, values, and strategies.<sup>9</sup>

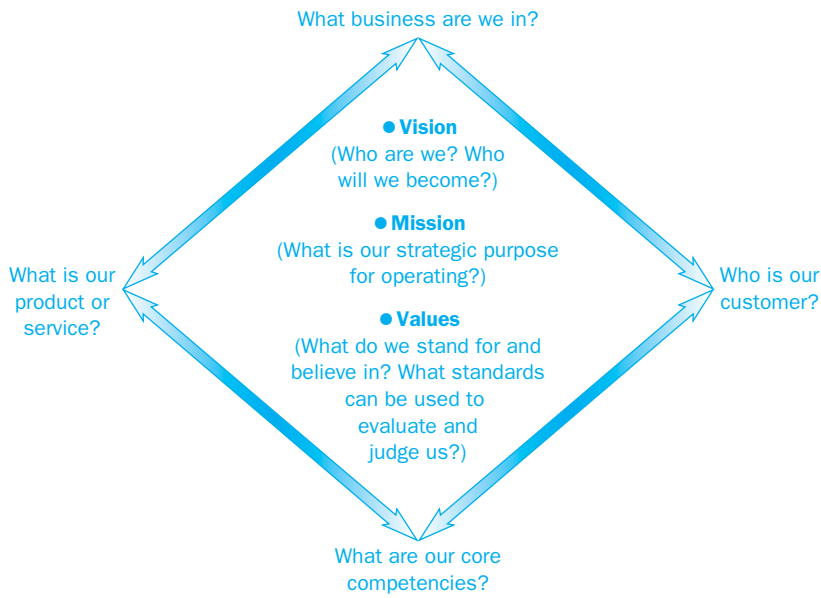
Effective leaders guide the ethical and strategic integration and alignment of the internal organization with the external environment. As the following sections show, competent leaders demonstrate different competencies in guiding and responding to their stakeholders and stockholders.

## Defining Purpose, Mission, and Values

Leading an organization begins by identifying and enacting purpose and ethical values that are central to internal alignment, external market effectiveness, and responsibility toward stakeholders. As Figure 6.1 shows, key questions executives must answer before identifying a strategy and leading their firm are centered on defining the organization's vision, mission, and values: *What business are we in? What is our product or service? Who are our customers? What are our core competencies?*

Figure 6.1

Strategic Alignment Questions



**SOURCE:** Copyright Joseph W. Weiss, Bentley College, Waltham, MA, 2009.

A values-based leadership approach is exemplified by Chester Barnard, who wrote in 1939 that effective leaders and managers “inspire cooperative personal decisions by creating faith in common understanding, faith in the probability of success, faith in the ultimate satisfaction of personal motives, and faith in the integrity of common purpose.”<sup>10</sup> In the classic book *Built to Last*,<sup>11</sup> authors James Collins and Jerry Porras state, “Purpose is the set of fundamental reasons for a company’s existence beyond just making money. Visionary companies get at purpose by asking questions similar to those posed by David Packard [cofounder of Hewlett-Packard] . . . ‘I want to discuss why a company exists in the first place . . . why are we here? I think many people assume, wrongly, that a company exists simply to make money. While this is an important result of a company’s existence, we have to go deeper and find the real reasons for our being.’”

JetBlue’s founder, David Neeleman, said:

For our company’s core values, we came up with five words: safety, caring, fun, integrity, and passion. We guide our company by them. But from my experience—and I’ve had a lot of life experiences that were deep religious experiences—I feel that everyone is equal in the way they should be treated and the way they should be respected. I think that I try to conduct myself in that way. I treat everyone the same: I don’t give anyone more deference because of their position or their status. Then I just try to create trust with our crewmembers. I know if they trust me, if they know I’m trying to do the best things I think are in their long-term interest, then they’ll be happier and they’ll feel like this is a better place to work.<sup>12</sup>

Ethical companies may also include a “social mission” in their formal mission and values statements. A social mission is a commitment by the organization to give back to their community and external stakeholders who make the organization’s existence possible. Ben and Jerry’s, Lands’ End, Southwest Airlines, and many other companies commit to serving their communities through different types of stewardship outreach, facility sharing (e.g., day care and tutoring programs), and other service-related activities.

A starting point for identifying a leader’s values is the vision and mission statement of the company. Levi Strauss & Co.’s now classic values and vision statement, shown in Figure 6.2, exemplifies an inspirational vision with ethical values.

Figure 6.2

### Levi Strauss & Co. Values and Vision Statement

#### VALUES

Our values are fundamental to our success. They are the foundation of our company, define who we are and set us apart from the competition. They underlie our vision of the future, our business strategies and our decisions, actions and behaviors. We live by them. They endure.

Four core values are at the heart of Levi Strauss & Co.: Empathy, Originality, Integrity and Courage. These four values are linked. As we look at our history, we see a story of how our core values work together and are the source of our success.

#### **Empathy—Walking in Other People’s Shoes**

Empathy begins with listening . . . paying close attention to the world around us . . . understanding, appreciating and meeting the needs of those we serve, including consumers, retail customers, shareholders and each other as employees.

Levi Strauss and Jacob Davis listened. Jacob was the tailor who in the 1870s first fashioned heavy cotton cloth, thread and metal rivets into sturdy “waist overalls” for miners seeking durable work pants. Levi in turn met Jacob’s needs for patenting and mass production of the product, enthusiastically embracing the idea and bringing it to life. The rest is history: The two created what would become the most popular clothing in the world—blue jeans.

Our history is filled with relevant examples of paying attention to the world around us. We listened. We innovated. We responded.

- As early as 1926 in the United States, the company advertised in Spanish, Portuguese and Chinese, reaching out to specific groups of often-neglected consumers.
- In the 1930s, consumers complained that the metal rivets on the back pockets of our jeans tended to scratch furniture, saddles and car seats. So we redesigned the way the pockets were sewn, placing the rivets underneath the fabric.

(continued)

● Figure 6.2

**Levi Strauss & Co. Values and Vision Statement (*continued*)**

- In 1982, a group of company employees asked senior management for help in increasing awareness of a new and deadly disease affecting their lives. We quickly became a business leader in promoting AIDS awareness and education.

We believe in empathetic marketing, which means that we walk in our consumers' shoes. In the company's early years, that meant making durable clothes for workers in the American West. Now, it means responding to the casual clothing needs of a broad range of consumers around the world. Understanding and appreciating needs—consumer insight—is central to our commercial success.

Being empathetic also means that we are inclusive. Levi Strauss' sturdy work pants are sold worldwide in more than 80 countries. Their popularity is based on their egalitarian appeal and originality. They transcend cultural boundaries. Levi's® jeans—the pants without pretense—are not just for any one part of society. Everyone wears them.

Inclusiveness underlies our consumer marketing beliefs and way of doing business. We bring our Levi's® and Dockers® brands to consumers of all ages and lifestyles around the world. We reflect the diverse world we serve through the range and relevancy of our products and the way we market them.

Likewise, our company workforce mirrors the marketplace in its diversity, helping us to understand and address differing consumer needs. We value ethnic, cultural and lifestyle diversity. And we depend and draw upon the varying backgrounds, knowledge, points of view and talents of each other.

As colleagues, we also are committed to helping one another succeed. We are sensitive to each other's goals and interests, and we strive to ensure our mutual success through exceptional leadership, career development and supportive workplace practices.

Empathy also means engagement and compassion. Giving back to the people we serve and the communities we operate in is a big part of who we are. Levi Strauss was both a merchant and a philanthropist—a civic-minded leader who believed deeply in community service. His way lives on. The company's long-standing traditions of philanthropy, community involvement and employee volunteerism continue today and contribute to our commercial success.

**Originality—Being Authentic and Innovative**

Levi Strauss started it and forever earned a place in history. Today, the Levi's® brand is an authentic American icon, known the world over.

Rooted in the rugged American West, Levi's® jeans embody freedom and individuality. They are young at heart. Strong and adaptable, they have been worn by generations of individuals who have made them their own. They are a symbol of frontier independence, democratic idealism, social change and fun. Levi's® jeans are both a work pant and a fashion statement—at once ordinary and extraordinary. Collectively, these attributes and values make the Levi's® brand unlike any other.

Figure 6.2

**Levi Strauss & Co. Values and Vision Statement (*continued*)**

Innovation is the hallmark of our history. It started with Levi's® jeans, but that pioneering spirit permeates all aspects of our business—innovation in product and marketing, workplace practices and corporate citizenship. Creating trends. Setting new standards. Continuously improving through change. For example:

- We were the first U.S. apparel company to use radio and television to market our products.
- With the introduction of the Dockers® brand in 1986, we created an entirely new category of casual clothing in the United States, bridging the gap between suits and jeans. A year later, Dockers® khakis had become the fastest growing apparel brand in history. Throughout the 1990s, we were instrumental in changing what office workers wear on the job.
- Our European Levi's® brand team reinvented classic five-pocket jeans in 1999. Inspired by the shape and movement of the human body, Levi's® Engineered Jeans™ were the first ergonomically designed jeans.

Now, more than ever, constant and meaningful innovation is critical to our commercial success. The worldwide business environment is fiercely competitive. Global trade, instantaneous communications and the ease of market entry are among the forces putting greater pressure on product and brand differentiation. To be successful, it is imperative that we change, competing in new and different ways that are relevant to the shifting times.

As the “makers and keepers” of Levi Strauss’ legacy, we must look at the world with fresh eyes and use the power of ideas to improve everything we do across all dimensions of our business, from modest improvements to total re-inventions. We must create product news that comes from the core qualities of our brands—comfort, style, value and the freedom of self-expression—attributes that consumers love and prefer.

**Integrity—Doing the Right Thing**

Ethical conduct and social responsibility characterize our way of doing business. We are honest and trustworthy. We do what we say we are going to do.

Integrity includes a willingness to do the right thing for our employees, brands, the company and society as a whole, even when personal, professional and social risks or economic pressures confront us. This principle of responsible commercial success is embedded in the company's experience. It continues to anchor our beliefs and behaviors today, and is one of the reasons consumers trust our brands. Our shareholders expect us to manage the company this way. It strengthens brand equity and drives sustained, profitable growth and superior return on investment. In fact, our experience has shown that our “profits through principles” approach to business is a point of competitive advantage.

This values-based way of working results in innovation:

- Our commitment to equal employment opportunity and diversity predates the U.S. Civil Rights movement and federally mandated desegregation by two decades. We opened integrated factories in California

(*continued*)



● Figure 6.2

**Levi Strauss & Co. Values and Vision Statement (*continued*)**

in the 1940s. In the 1950s, we combined our need for more production and our desire to open manufacturing plants in the American South into an opportunity to make change: We led our industry by sending a strong message that we would not locate new plants in Southern towns that imposed segregation. Our approach changed attitudes and helped to open the way for integration in other companies and industries.

- In 1991, we were the first multinational company to develop a comprehensive code of conduct to ensure that individuals making our products anywhere in the world would do so in safe and healthy working conditions and be treated with dignity and respect. Our Terms of Engagement are good for the people working on our behalf and good for the long-term reputation of our brands.

Trust is the most important value of a brand. Consumers feel more comfortable with brands they can trust. Increasingly, they are holding corporations accountable not only for their products but also for how they are made and marketed. Our brands are honest, dependable and trusted, a direct result of how we run our business.

Integrity is woven deeply into the fabric of our company. We have long believed that “Quality Never Goes Out of Style®” Our products are guaranteed to perform. We make them that way. But quality goes beyond products: We put quality in everything we do.

**Courage—Standing Up for What We Believe**

It takes courage to be great. Courage is the willingness to challenge hierarchy, accepted practices and conventional wisdom. Courage includes truth telling and acting resolutely on our beliefs. It means standing by our convictions. For example:

- It took courage to transform the company in the late 1940s. That was when we made the tough decision to shift from dry goods wholesaling, which represented the majority of our business at the time, and to focus instead on making and selling jeans, jean jackets, shirts and Western wear. It was a foresighted—though risky—decision that enabled us to develop and prosper.
- In the 1980s, we took a similar, bold step to expand our U.S. channels of distribution to include two national retail chains, Sears and JCPenney. We wanted to provide consumers with greater access to our products. The move resulted in lost business in the short term because of a backlash from some important retail customers, but it set the stage for substantial growth.
- We also demonstrated courage in our workplace practices. In 1992, Levi Strauss & Co. became the first Fortune 500 company to extend full medical benefits to domestic partners of employees. While controversial at the time, this action foreshadowed the widespread acceptance of this benefit and positioned us as a progressive employer with prospective talent.

With courage and dedication, we act on our insights and beliefs, addressing the needs of those we serve in relevant and significant ways. We do this with an unwavering commitment to excellence. We hold ourselves accountable for attaining the high performance standards

Figure 6.2

**Levi Strauss & Co. Values and Vision Statement (*continued*)**

and results that are inherent in our goals. We learn from our mistakes. We change. This is how we build our brands and business. This is how we determine our own destiny and achieve our vision of the future.

The story of Levi Strauss & Co. and our brands is filled with examples of the key role our values have played in meeting consumer needs. Likewise, our brands embody many of the core values that our consumers live by. This is why our brands have stood the test of time.

Generations of people have worn our products as a symbol of freedom and self-expression in the face of adversity, challenge and social change. They forged a new territory called the American West. They fought in wars for peace. They instigated counterculture revolutions. They tore down the Berlin Wall. Reverent, irreverent—they all took a stand.

Indeed, it is this special relationship between our values, our consumers and our brands that is the basis of our success and drives our core purpose. It is the foundation of who we are and what we want to become:

**VISION**

People love our clothes and trust our company.  
We will market the most appealing and widely worn  
casual clothing in the world.  
We will clothe the world.

**SOURCE:** Levi Strauss & Co. Reprinted by permission.

The classical visionary, “built-to-last” companies “are premier institutions—the crown jewels—in their industries, widely admired by their peers, and have a long track record of making a significant impact on the world around them . . . a visionary company is an *organization*—an institution . . . visionary *companies* prosper over long periods of time, through multiple product life cycles and multiple generations of active leaders.”<sup>13</sup> Such companies included 3M, American Express, Boeing, Citicorp, Ford, General Electric, Hewlett-Packard, IBM, Johnson & Johnson, Marriott, Merck, Motorola, Nordstrom, Philip Morris, Procter and Gamble, Sony, Wal-Mart, and Disney. These visionary companies, Collins and Porras discovered, succeeded over their rivals by developing and following a “core ideology” that consisted of core values plus purpose. Core values are “the organization’s essential and enduring tenets—a small set of general guiding principles; not to be confused with specific cultural or operational practices; not to be compromised for financial gain or short-term expediency.” Purpose is “the organization’s fundamental reasons for existence beyond just making money—a perpetual guiding star on the horizon; not to be confused with specific goods or business strategies.”<sup>14</sup> Excerpts of core ideologies from some of the classic visionary companies are instructive and are summarized here:<sup>15</sup>

- Disney: “To bring happiness to millions and to celebrate, nurture, and promulgate wholesome American values.”
- Wal-Mart: “We exist to provide value to our customers—to make their lives better via lower prices and greater selection; all else is secondary . . . Be in partnership with employees.”

- Sony: “Respecting and encouraging each individual’s ability and creativity.”
- Motorola: “To honorably serve the community by providing products and services of superior quality at a fair price.”

Built-to-last companies “more thoroughly indoctrinate employees into a core ideology than their comparison companies (i.e., those companies in Collins and Porras’s study that did not last), creating cultures so strong that they are almost cult-like around the ideology.”<sup>16</sup> Visionary companies also select and support senior management on the basis of whether they fit with the core ideology. These best-in-class companies also attain more consistent goals, strategy, and organizational structure alignment with their core ideology than do comparison companies in Collins and Porras’s study.<sup>17</sup>

## ETHICAL INSIGHT 6.1



### Your Moral Leadership Profile

Using actual situations in which you served in a leadership role, score the following statements with regard to how each statement characterizes your leadership style:

1 = Very little, 2 = Somewhat, 3 = Moderately, 4 = A lot, 5 = Most of the time

1. I follow ethical principles even if I would not be taken seriously. 1 2 3 4 5
2. I would not “cave in” to pressure from bullies or pushy people. 1 2 3 4 5
3. I let everyone know when something is not fair or just. 1 2 3 4 5
4. I do not get tense or anxious under pressure. 1 2 3 4 5
5. I speak out and let everyone know the truth, regardless of possible consequences. 1 2 3 4 5
6. I don’t follow the majority opinion, seeking approval of a group’s views if those views are unjust. 1 2 3 4 5

7. I follow ethical values in my decisions and actions, rarely making decisions randomly. 1 2 3 4 5
8. I am not afraid to say “no” and disagree even though I might lose personal stature. 1 2 3 4 5
9. I take risks to support my beliefs even if I become unpopular with the group. 1 2 3 4 5
10. I would follow the mission of the project even if I lose personal face and approval. 1 2 3 4 5

### Your Scores and Interpretation

Add up your scores. Total of 10 statements = \_\_\_\_\_. If you received 40 or higher, you are considered a courageous leader. A score of 20 or below indicates you avoid conflict and difficult situations that challenge your moral leadership. Examine the items in which you scored highest and lowest. Do these scores and items reflect your moral courage in tough situations generally? Why or why not? What do you need to do to improve or change your moral courage? How do your scores compare to other students’?

**SOURCE:** From *The Leadership Experience*, 3rd edition by Daft. © 2005. Reprinted with permission of South-Western, a division of Thomson Learning: [www.thomsonrights.com](http://www.thomsonrights.com). Fax 800-730-2215.

## Leadership Stakeholder Competencies

Core competencies of responsible leaders include the ability to:

1. Define and lead the social, ethical, and competitive mission of organizations. This includes community-based, social, and environmental stewardship goals that promote being a global corporate citizen.<sup>18</sup>
2. Build and sustain accountable relationships with stakeholders.<sup>19</sup>
3. Dialogue and negotiate with stakeholders, respecting their interests and needs beyond economic and utilitarian dimensions.<sup>20</sup>
4. Demonstrate collaboration and trust in shared decision making and strategy sessions.
5. Show awareness and concern for employees and other stakeholders in the policies and practices of the company.

Effective ethical leaders develop a collaborative approach to setting direction, leading top-level teams, and building relationships with partners and customers. For example, at Johnson & Johnson, one of the seven principles of leadership development states: “People are an asset of the corporation; leadership development is a collaborative, corporation-wide process.”<sup>21</sup> The company lives its leadership principles through its Executive Development Program. Figure 6.3 shows Johnson & Johnson’s Credo. The now classic “Beliefs of Borg-Warner” corporation credo is also shown in Figure 6.4 as another example of values companies should aspire to follow.

Figure 6.3

### Johnson & Johnson Credo

We believe our first responsibility is to the doctors, nurses, and patients; to mothers and fathers; and all others who use our product and services. In meeting their needs, everything we do must be of high quality.

We must constantly strive to reduce our costs in order to maintain reasonable prices.

Customers’ orders must be serviced promptly and accurately.

Our suppliers and distributors must have an opportunity to make a fair profit.

We are responsible to our employees, the men and women who work with us throughout the world.

Everyone must be considered as an individual. We must respect their dignity and recognize their merit.

They must have a sense of security in their jobs.

Compensation must be fair and adequate, and working conditions clean, orderly, and safe.

We must be mindful of ways to help our employees fulfill their family responsibilities.

Employees must feel free to make suggestions and complaints.

There must be equal opportunity for employment, development, and advancement for those qualified.

We must provide competent management, and their actions must be just and ethical.

(continued)

Figure 6.3

**Johnson & Johnson Credo (*continued*)**

We are responsible to the communities in which we work and to the world community as well.

We must be good citizens—support good works and charities and bear our fair share of taxes.

We must encourage civic improvements and better health and education.

We must maintain in good order the property we are privileged to use, protecting the environment and natural resources.

Our final responsibility is to our stockholders.

Business must make a sound profit.

We must experiment with new ideas.

Research must be carried on, innovative programs developed, and mistakes paid for.

New equipment must be purchased, new facilities provided, and new products launched.

Reserves must be created to provide for adverse times.

When we operate according to these principles, the stockholders should realize a fair return.

**SOURCE:** Johnson & Johnson. Used by permission of Johnson & Johnson, the copyright owner.

Organizational leaders are also ultimately responsible for the economic viability and profitability of a company. From a values-based, stakeholder management perspective, leaders must also oversee and implement the following in their organizations:

- Set the vision, mission, and direction.
- Create and sustain a legal and ethical culture throughout the organization.
- Articulate and guide the strategy and direction of the organization.
- Ensure the competitive and ethical alignment of organizational systems.
- Reward ethical conduct.<sup>22</sup>

Herb Kelleher cofounded Southwest Airlines in 1966 on a personal \$10,000 investment. He retired June 19, 2001, with a \$200 million stake in the company. Kelleher's principles of management are straightforward and simple:<sup>23</sup>

- Employees come first, customers second.
- The team is important, not the individual.
- Hire for attitude, train for skills.
- Think like a small company.
- Eschew organizational hierarchy.
- Keep it simple.

Figure 6.4

## The Beliefs of Borg-Warner: To Reach Beyond the Minimal

Any business is a member of a social system, entitled to the rights and bound by the responsibilities of that membership. Its freedom to pursue economic goals is constrained by law and channeled by the forces of a free market. But these demands are minimal, requiring only that a business provide wanted goods and services, compete fairly, and cause no obvious harm. For some companies, that is enough. It is not enough for Borg-Warner. We impose upon ourselves an obligation to reach beyond the minimal. We do so convinced that by making a larger contribution to the society that sustains us, we best assure not only its future vitality, but our own.

This is what we believe.

### We Believe in the Dignity of the Individual

However large and complex a business may be, its work is still done by dealing with people. Each person involved is a unique human being, with pride, needs, values, and innate personal worth. For Borg-Warner to succeed, we must operate in a climate of openness and trust, in which each of us freely grants others the same respect, cooperation, and decency we seek for ourselves.

### We Believe in Our Responsibility to the Common Good

Because Borg-Warner is both an economic and social force, our responsibilities to the public are large. The spur of competition and the sanctions of the law give strong guidance to our behavior, but alone do not inspire our best. For that we must heed the voice of our natural concern for others. Our challenge is to supply goods and services that are of superior value to those who use them; to create jobs that provide meaning for those who do them; to honor and enhance human life; and to offer our talents and our wealth to help improve the world we share.

### We Believe in the Endless Quest for Excellence

Though we may be better today than we were yesterday, we are not as good as we must become. Borg-Warner chooses to be a leader—in serving our customers, advancing our technologies, and rewarding all who invest in us their time, money, and trust. None of us can settle for doing less than our best, and we can never stop trying to surpass what already has been achieved.

### We Believe in Continuous Renewal

A corporation endures and prospers only by moving forward. The past has given us the present to build on. But to follow our visions to the future, we must see the difference between traditions that give us continuity and strength and conventions that no longer serve us—and have the courage to act on that knowledge. Most can adapt after change has occurred; we must be among the few who anticipate change, shape it to our purpose, and act as its agents.

*(continued)*

● Figure 6.4

### The Beliefs of Borg-Warner: To Reach Beyond the Minimal (continued)

#### We Believe in the Commonwealth of Borg-Warner and Its People

Borg-Warner is both a federation of businesses and a community of people. Our goal is to preserve the freedom each of us needs to find personal satisfaction while building the strength that comes from unity. True unity is more than a melding of self-interests; it results when values and ideals also are shared. Some of ours are spelled out in these statements of belief. Others include faith in our political, economic, and spiritual heritage; pride in our work and our company; the knowledge that loyalty must flow in many directions; and a conviction that power is strongest when shared. We look to the unifying force of these beliefs as a source of energy to brighten the future of our company and all who depend on it.

**SOURCE:** Borg-Warner Corp. The beliefs of Borg Warner: To reach beyond the minimal. Reprinted with permission of the Borg-Warner Corporation.

Kelleher owned and operated Southwest Airlines on these principles. When asked how the company would survive once he stepped down, Kelleher responded, “The real answer is we have a very strong culture and it has a life of its own that is able to surmount a great deal. If we should, by happenstance, have someone succeed me who is not interested in the culture, I don’t think they would last a long time. The place would just rise up.”<sup>24</sup> Kelleher’s message is printed in white letters on the black elevator glass in the lobby of Southwest’s corporate headquarters:

The people of Southwest Airlines are the creators of what we have become—and what we will be. Our people transformed an idea into a legend. That legend will continue to grow only so long as it is nourished—by our people’s indomitable spirit, boundless energy, immense goodwill, and burning desire to excel. Our thanks—and our love—to the people of Southwest Airlines for creating a marvelous family and a wondrous airline.<sup>25</sup>

Leaders who dare to be different through stretch-goals while maintaining a moral, values-based approach:

- Seek to revolutionize every strategy and process for optimal results while maintaining the organization’s integrity.<sup>26</sup>
- Empower everyone to perform beyond stated standards, while maintaining balance of life and personal values.
- Understand and serve customers as they would themselves.
- Create and reward a culture obsessed with fairness and goodwill toward everyone.
- Act with compassion and forgiveness in every decision toward every person and group.
- Do unto their stockholders and stakeholders as they would have them do to their company.
- Treat the environment as their home.

## Example of Companies Using Stakeholder Relationship Management

A recent study of exemplary firms that have gone beyond traditional business models are termed, “firms of endearment” (FoE). Leaders of these firms practice “stakeholder relationship management.”<sup>27</sup> An FoE is “a company that *endears* itself to stakeholders by bringing the interests of all stakeholder groups into strategic alignment. No stakeholder group benefits at the expense of any other stakeholder group, and each prospers as the others do.”<sup>28</sup> The authors’ (Sisodia, Sheth, and Wolfe) two-year research project started with measures of “humanistic performance—meeting the needs of stakeholders other than shareholders—and worked forward.” The authors “asked for nominations from thousands of people all over the world, including business professionals, marketing professionals, MBA students, and about 1,000 consumers.”<sup>29</sup> The companies selected underwent further screening using quantitative and qualitative performance of each firm for each stakeholder (societal communities, partners, investors, customers, and employees). The companies studied are not exhaustive—some are repeated in earlier studies above—and the authors note that none of the firms are perfect. It was found that “the public FoEs returned 1,026% for investors over the 10 years ending June 30, 2006, compared to 122% for the S&P 500...an 8–1 ratio!”<sup>30</sup> The companies in the “final cut” include:

Amazon	Honda	Southwest
BMW	IDEO	Starbucks
CarMax	IKEA	Timberland
Caterpillar	JetBlue	Toyota
Commerce Bank	Johnson & Johnson	Trader Joe’s
Container Store	Jordan’s Furniture	UPS
Costco	LL Bean	Wegmans
eBay	New Balance	Whole Foods
Google	Patagonia	
Harley-Davidson	REI	

Some of the defining characteristics of FoEs include the following characteristics:

- Competitive advantage through a business model in which all stakeholders add and benefit from gains in value created from a deeper set of resources.
- Possess a humanistic soul. “From the depths of this soul, the will to render uncommon service to all stakeholders flows. These companies are imbued with the joy of service—to the community, to society, to the environment, to customers, to colleagues.”<sup>31</sup>
- Leaders who “facilitate, encourage, reward, recognize, and celebrate their employees for being of service to their communities and the world at large, for no reason other than that it is the right thing to do.”

A sample of FoE characteristics follows. Honda “marries suppliers for life”; the company supports suppliers in improving quality, service, and profits. IKEA abides by all laws, no matter how strict, in every country



where it operates. Costco's co-founder and CEO Jim Sinegal embodies the stakeholder management approach. His salary in August 2007 was \$350,000, with a bonus of \$100,000; Costco's merchandise sales in its most recent fiscal year rose 14% to \$59 billion. (The average CEO compensation of an S&P 500 company in 2007 was \$15.2 million.<sup>32</sup>) Costco's low employee turnover and liberal benefits have created loyalty in an industry that is standard-setting. Southwest Airlines has an elected "Culture Committee" consisting of 96 employees in charge of sustaining the company's humanistic culture. JetBlue's founder David Neeleman quickly responded to the post-2007 Valentine's Day crisis when passengers were kept on board planes that had been grounded due to weather conditions. Neeleman instituted "employee cross-training so that all 900 of the corporate employees in JetBlue's Forest Hills office could assist at nearby JFK during any future operational crisis." Neeleman also initiated action on a customer's bill of rights document. All the FoE companies and their leaders exhibited these types of stakeholder relationship management actions, attributes, and policies.

## Spiritual Values, Practices, and Moral Courage in Leading

John Kotter of Harvard University said:

What we call courage is a strong emotional commitment—and the keyword is emotional—to some ideas. Those ideas could be called a vision for where we're trying to drive the enterprise. They could be called values for what we think is important in life. They could be called principles of what is right and wrong. When people don't just have an intellectual sense that these are logically good, but are deeply committed to them, they're developing courage. When you run up against barriers that keep you from those ideals, the stronger your commitment, the more likely you are to take action consistent with those ideals. Even if it's against your short-term best interests . . . The bigger the context, the greater the barriers, the more the snake pits . . . the more there will be times for courageous acts.<sup>33</sup>

Moral courage comes from the heart and soul as well as the head. When leaders face extreme dilemmas where not only their own but their organization's reputation or existence is at stake based on the course of action that must be taken (or not taken), they come to know the meaning of this type of courage. An emerging body of literature describes leadership from just such a spiritual perspective.<sup>34</sup> Spirituality, broadly defined, is the search for "ultimate meaning and purpose in one's life."<sup>35</sup> This dimension of leadership is inherently linked to ethics in that leaders act as stewards and servants<sup>36</sup> who do "the right thing" for their followers, communities, and society. Spiritual values and practices are also the sources of **moral courage**, which is the ability to act with wisdom of the soul against fear, greed, conformity, and pressures that work against the common good. Spiritual values originate from a deeper wisdom of having a sense of purpose and "knowing yourself." Some religious traditions, including Christianity, link this deeper knowing to a person's "calling" that is discovered and nurtured from their relationship with community and the source of their spiritual

guidance. The following characteristics illustrate leadership from a spiritual perspective:<sup>37</sup>

- Understand and practice reflective “being” as well as “doing”; genuine spirituality must be the willingness to enter into the process of dialogue with oneself and with others, and to try to stay with it over a period of time. “Being is the only reality with integrity; obeying one’s conscience brings one into communion with this ‘integrity of Being.’”<sup>38</sup>
- Use discernment, prayer, and patience in strategic decision making. Decisions are analyzed within the context of communities.
- See the leadership role as a calling that reveals its presence by the enjoyment and sense of renewed energy in the practice and results yielded.
- Seek to connect with people and connect people to people with meaning and in meaningful ways.
- Create communities, environments, and safe havens for empowerment, mobilization, development, spiritual growth, and nourishment.
- Lead with reflection, choice, passion, reason, compassion, humility, vulnerability, and prayer, as well as courage, boldness, and vision.

Spiritually based values and practices of leaders have been shown to positively affect their stakeholder relationships as well as performance:

The spiritual values of integrity, honesty, and humility, and the spiritual practices of treating others with respect and fairness, expressing caring and concern, listening responsively, appreciating others, and taking time for personal reflection have all been linked to quantifiable positive effects for organizations and individuals. They cause leaders to be judged as more effective by both their peers and their subordinates, and they lead to enhanced performance. They have been proven to be associated with increased worker satisfaction and motivation, greater productivity, greater sustainability, and enhanced corporation reputation, which in turn have all been linked to increases in the bottom line of profits.<sup>39</sup>

Aaron Feuerstein, founder of Malden Mills Industries, Inc., Tom Chappell of Tom’s of Maine, Jeffrey Swartz of The Timberland Company, David Steward of World Wide Technology, Inc., and Krishan Kalra of BioGenex Laboratories, Inc. are a few of a growing number of executives who have used their spiritual beliefs in their professional lives to create and promote strategies and policies involving employees, customers, suppliers, vendors, their communities, and other stakeholders. JetBlue’s David Neeleman also admits that his Mormon background and “missionary” responsibilities as a youth influenced his continuing values and practices toward his employees and stakeholders.<sup>40</sup>

The study by Ian Mitroff and Elizabeth Denton<sup>41</sup> interviewed 215 executive officers and managers. A surprising finding in the study was that the leaders desired a way to express their spiritual selves while at work, rather than to “park it at the office door.” Leaders and organizations enable the expression of spirituality in different ways: from the *religious firm*, where religious teachings are openly articulated, modeled, and included in business practices, to the *values-based company* (like Ben & Jerry’s), where secular values (awareness, consciousness, dignity, honesty, openness, and trust) are guides in the firm. In these types of firms, the Golden Rule is the major business principle and “the whole person comes to work” and “causes no embarrassment by expressing ‘deeply felt emotions’ such as love and grieving.”<sup>42</sup>

## Failure of Ethical Leadership

Corporate leaders can and do fail when their decisions lack moral courage. The examples and cases in this text regarding U.S. corporate scandals clearly demonstrated that corruption started at the top. There are also classic scenarios of leaders who violated their legal and ethical responsibilities to stockholders and stakeholders. Micky Monus, former CEO of the Phar-Mor company (a failed discount retail drugstore chain that attempted to take on Wal-Mart), was sentenced to 20 years in prison and fined \$1 million on December 12, 1995, when he was “convicted on all counts of a 109-count indictment that charged him with conspiracy to commit mail fraud, wire fraud, bank fraud, and transportation of funds obtained by theft or fraud.” Monus was hailed as a community hero in Youngstown, Ohio, when he led Phar-Mor to historical growth. But his charismatic, entrepreneurial personality and leadership had a dark side—greed, deceit, and theft. His influence also led his young finance management team into massive theft, fraud, and cover-up.<sup>43</sup>

There was also “Chainsaw Al” Dunlap, former CEO of Sunbeam, who was fired following a Securities and Exchange Commission investigation of accounting fraud under his watch. Dunlap was known for his ability to achieve profits. To meet Sunbeam’s profit projections and appease Wall Street analysts, Dunlap devised a method of selling Sunbeam spare parts (used to fix broken blenders and grills) for \$11 million to a company that warehoused the parts. That company valued the parts at \$2 million. Dunlap and company pressured the warehouse firm to sign a contract to buy the parts at \$11 million, booking \$8 million in profit. (The parts were never sold.) He was instrumental in laying off large numbers of employees and cutting back organizational operations to achieve profitability.<sup>44</sup> Dunlap described his other approaches to doing business in his book *Mean Business: How I Save Bad Companies and Make Good Companies Great*.<sup>45</sup>

Seven symptoms of the failure of ethical leadership provide a practical lens to examine a leader’s shortsightedness:<sup>46</sup>

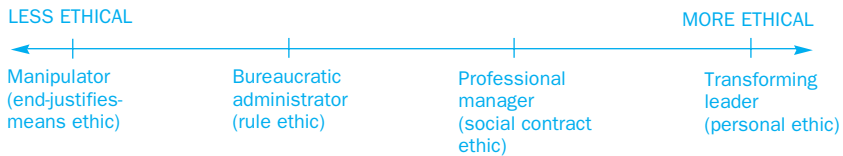
1. Ethical blindness: They do not perceive ethical issues due to inattention or inability.
2. Ethical muteness: They do not have or use ethical language or principles. They “talk the talk” but do not “walk the talk” on values.
3. Ethical incoherence: They are not able to see inconsistencies among values they say they follow; e.g., they say they value responsibility, but reward performance based only on numbers.
4. Ethical paralysis: They are unable to act on their values from lack of knowledge or fear of the consequences of their actions.
5. Ethical hypocrisy: They are not committed to their espoused values. They delegate things they are unwilling to or cannot do themselves.
6. Ethical schizophrenia: They do not have a set of coherent values; they act at work one way, at home another way.
7. Ethical complacency: They believe they can do no wrong because of who they are. They believe they are immune to being unethical.

## Ethical Dimensions of Leadership Styles

Every leadership style has an ethical dimension. The following spectrum of styles is illustrated here because it reflects some of the ethical principles discussed in Chapter 3. An organizational leader's (as well as your own) moral decision-making style can also be evaluated using the following continuum, shown in Figure 6.5.<sup>47</sup>

Figure 6.5

### Moral Leadership Styles



The *manipulator* leadership style is based on a Machiavellian principle that views leadership amorally. That is, the end result justifies the means taken to reach it. Power is the driving force behind a manipulator's motives. This is an egotistically and essentially economically motivated moral leadership style. Leaders who lack trust and interest in relationship building and are oriented toward the short term may also be manipulators. Although the motives underlying this style may be amoral, the consequences could prove immoral. Have you ever worked under someone who used this style?

The *bureaucratic administrator* is a rule-based moral leadership style. Based on the theories of German sociologist Max Weber,<sup>48</sup> the bureaucratic administrator acts on the rational principles embodied in an ideal organizational bureaucracy, i.e., fixed rules that explain the purpose and functions of the organization; a hierarchy that shows the chain-of-command; well-defined job descriptions; professional managers who communicate and enforce the rules; and technically qualified employees who are promoted by expertise and rewarded by rank and tenure. The driving force behind this style is efficiency ("doing things right," functioning in the least wasteful manner) more than effectiveness (producing the intended result or aim, "doing the right things"). Although this leadership style has an admirable aim of basing decisions only on objective, rational criteria, the moral problem with it lies in the "sin of omission." That is, a leader may follow all the rules exactly but hurt someone unintentionally by not attending to legitimate human needs because the option to do so was not included in the rules.

For example, a military captain may follow remote orders of a general by sending a regiment into a battle zone that he knows will lead to disaster based on available "on the ground" conditions. Nevertheless, rather than risk disobeying orders and the formal consequences, he proceeds. Another captain who has a different moral leadership style may choose to risk disobeying orders to save the troops. Rules for overly bureaucratic leaders can become ends in themselves.

Rules cannot address all problems and needs in what we know are imperfect and political organizations. The well-intentioned bureaucratic

administrator may try to act amorally, but his or her efforts could result in immoral and irresponsible consequences. Do you recognize this moral leadership style? Have you ever worked for someone who used it?

The *professional* manager aims at effectiveness and “doing things right.” This style is grounded in Peter Drucker’s<sup>49</sup> view of managers as professionals who have the expertise and tools for accomplishing work effectively through others. Based on a social contract, this management style relies—like the previous two styles—on amorality for getting work done. For example, professional career managers use rational objectives and their training to accomplish the organization’s work. The organization’s corporate culture and the social contract—implicit and explicit agreements—made between managers and organizational executives set the ground rules that govern the manager’s behavior. However, social contracts are not always ethical.

An ethical problem with this leadership style lies in the real possibility that the collective corporate culture and the dominant governing group may think and act amorally or immorally. *Groupthink* (consensus-dominated decision making, based on uncritical, biased thinking) may occur.<sup>50</sup> The collective may lead itself astray. Professional managers, by training, are still prone to unethical behavior. Do you recognize managers or leaders who act amorally or immorally as “professionals”?

Finally, the *transforming* leadership style, based on James Burns’ theory,<sup>51</sup> is grounded on a personal ethic. The transformational leader bases his or her effectiveness on relationships with followers. Also, this style focuses on the charisma, energy, and excitement the leader brings to relationships. The transformational leader is involved in the growth and self-actualization of others and views others according to their potential. This type of leader identifies and elevates the values of others. He or she empowers, coaches, and helps promote other leaders. This leadership style is moral because “it raises the level of human conduct and aspirations of both leaders and led, and thus has a transforming effect on both.”<sup>52</sup>

William Hitt<sup>53</sup> moved the continuum of moral leadership one step beyond the transformational leader to what he termed an “encompassing approach to leadership,” or “the effective leader–manager.” The encompassing leader learns from the shortcomings of each of the four leadership styles on the continuum and uses all of their strengths.

For example, manipulative leadership does value the effective use of power. However, this style’s deceptive and dysfunctional use of power should be avoided. The bureaucratic administrator values the effective use of rules; however, these should not become ends rather than means. The professional manager values results; however, human concerns should be valued more highly than physical and fiscal results. The transformational leader values human empowerment; however, even this characteristic is not the complete job of management.

Socially and morally responsible leaders should observe their obligations to all stakeholders, including their own conscience, and observe in their dealings the ethical principles of rights, justice, and duty—in addition to utilitarian logic. Richard Branson, founder and chairman of the Virgin Group, is another example of a popular global leader who practices ethical stakeholder management. A partial list of influential actions in 2007 include his

Virgin Airlines blowing the whistle on an illegal airline cargo price collusion and Virgin ponying up a \$25 million prize for whomever can develop a commercially viable design to cut down on greenhouse gasses (Virgin Earth).<sup>54</sup> Branson noted in a CNN interview, “I would say ... most important is how good you are with dealing with people, you know, whether you’re a good motivator of people. And I think that, no question, that ethics should play a big part, I think, for a company. If you deal well with people and fairly with people, then people will want to continue to deal with you and come back for more.” He continued on a related topic about business ethics: “If we’d wanted to fly to a particular country in this world—and I’m not to talk about America—you know, as a country we desperately wanted to fly to, we’d wanted to fly years ago, and we were willing to slip some money under the table, it would have cost next to nothing to get a license to fly to it. We felt that was wrong. And we just wouldn’t do something like that. And, therefore, it took us 10 years before we legitimately got the license. And so I think it’s very important that you sleep well at nights and that you run your company in an ethical way.”<sup>55</sup>

## How Should CEOs as Leaders Be Evaluated and Rewarded?

**CEO Pay: Excessive or Earned?** Fair and just compensation systems for executives and professionals are necessary for creating long-term corporate value, and encouraging active participation in the legal, ethical, and business effectiveness of firms. Pay and compensation are not the only ways organizational leaders, CEOs in particular, are compensated. There are also intrinsic as well as extrinsic rewards that motivate leaders, especially those who follow the servant and stewardship models. However, many CEOs of large, publicly traded firms are selected and evaluated based on their level of pay and compensation. It is important to reiterate that most CEOs, especially in small, medium, and even large firms earn their salaries and benefits from the value they create for their companies. And although many have increased the revenue and market value of their firms many times over, there are, however, a large number of CEOs whose pay and compensation drastically exceeds their firm’s performance.

Lucian Bebchuk, Harvard law professor and co-author of the book *Pay Without Performance, the Unfulfilled Promise of Executive Compensation*, stated that “Executive compensation is a good proxy for the level of accountability in the system. The interests of executives here are very strong. Making concession on compensation is much more painful than concessions on other dimensions. They still remain insufficiently accountable.”<sup>56</sup> Consider these facts, “The chief executive officers of large U.S. companies averaged \$10.8 million in total compensation in 2006, more than 364 times the pay of the average U.S. worker, according to the latest survey by United for a Fair Economy.”<sup>57</sup> According to a recent study by ERI Economic Research Institute and *The Wall Street Journal*, executive compensation grew substantially faster than corporate earnings in the past year. The study of 45 randomly selected public companies found that

executive compensation increased 20.5 percent from a year ago, while revenues grew just 2.8 percent.”<sup>58</sup>

Several issues are at stake here. First, after the corporate scandals, many investors and the public are more skeptical of CEO pay and performance. Second, many CEOs who have been with the same company most of their careers are looking toward retirement and do not need bonuses or perks that they could well afford on their own. Third, the salary increases, stock options, and perks are offered even when the company’s performance is sub-optimal and layoffs are occurring. Fourth, the CEO’s pay can be 20, 30, or 50 times higher than the salaries of some first-line managers and supervisors. However, a difference of more than a factor of seven is considered sizable for an average CEO position. Finally, although CEOs certainly bear greater responsibility, risk, and blame for a company’s successes and failures, one question remains: Why are CEO salaries and perks not linked more to performance? Activist shareholders are beginning to address this question and issue. For example, in 2007, shareholders howled when they discovered that Robert Nardelli’s contract as chief of The Home Depot enabled him to command a severance package totaling \$210 million when he was ousted. The Home Depot board did not make the same mistake when it wrote the contract for Frank Blake, Nardelli’s successor. “Frank Blake’s package is so tied to performance that it is almost the mirror image of Nardelli’s,” said Minow of the Corporate Library. “Home Depot went from the worst pay package imaginable to one that is close to exemplary.”<sup>59</sup>

**CEO Evaluations** The board of directors of a company is technically responsible for disciplining and rewarding the CEO. A Korn/ Ferry survey of board members found that 72% of the largest U.S. companies do a formal CEO evaluation.<sup>60</sup> Evidence shows that “CEO appraisals require a special commitment from the CEO and from the board members” in order for the process to work well and the results to be meaningful.<sup>61</sup> However, in many instances, it is the CEO who is also president of the company and chairperson of the board.

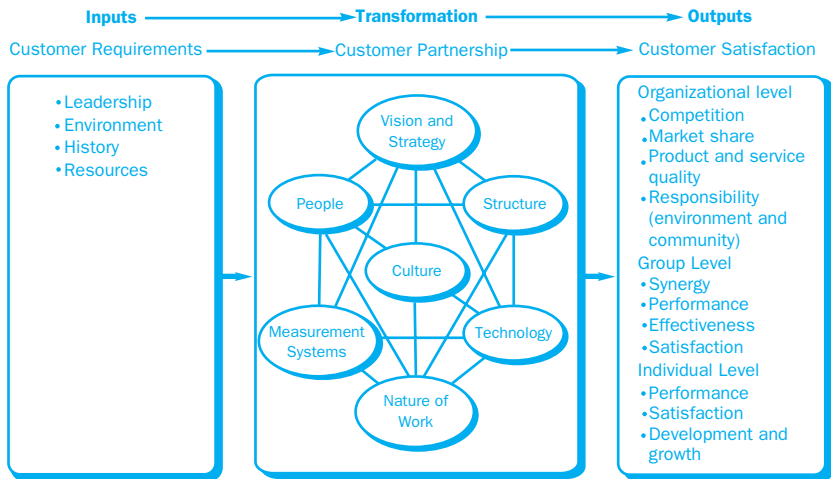
Two forces influence the popularity of boards of directors evaluating CEOs. The first is the increased recognition of the critical roles CEOs play and the increased compensation levels received for those roles. The second influential force is pressure from the investment community, which dates back to the beginning of shareholder awareness in the 1980s, when corporate acquisitions and restructuring activities were questioned with regard to the effectiveness of CEOs and their boards, due diligence, and management practices. Still, not all CEOs are formally evaluated with their top-level team members and other employees. For publicly traded companies, such as those listed on the New York Stock Exchange, NASDAQ, and other trading companies, industry analysts constantly score and keep pressure on the performance of CEOs and chief financial officers (CFOs)—by the numbers. Market performance is a major evaluator of these officers’ effectiveness. Annual reports and financial audits available to stockholders are another form of assessing leaders.

CEOs are also evaluated by assessing gaps between their stated and enacted strategies and by using customer and employee surveys. Assessments of the organization’s systems are also reflections of the leader’s



Figure 6.6

### Contingency Alignment Model



**SOURCE:** Copyright Joseph W. Weiss, Bentley College, Waltham, MA, 2009.

overall effectiveness in directing, aligning, and implementing strategy. Finally, leaders must balance and align stakeholder interests with the dominant mission and values of the company. Certainly not all CEOs are overpaid. Still, many critics argue that CEO pay and compensation in the larger, publicly traded companies are not in line with the performance of their firms, especially over the last decade.

## 6.2 ORGANIZATIONAL CULTURE, COMPLIANCE, AND STAKEHOLDER MANAGEMENT

The Ethics Resource Center's most recent survey reported a reduction by 75% of misconduct in companies with strong ethical cultures. Yet fewer than 1 in 10 companies today has a strong ethical culture in place. If U.S. businesses viewed ethics as building reputational capital—protecting corporate brand and preventing misconduct—ethics risk in the U.S. would be substantially reduced.<sup>62</sup> The survey also reported that “ethics risk diminishes when a company adopts an enterprise-wide cultural approach to business ethics.”<sup>63</sup> Interestingly, the same survey found that only 9% of U.S. companies actually have strong ethical cultures. On a less than positive note, the survey concluded that: “Despite some gains in the wake of attention to corporate scandals in 2001 and 2002, over the past few years, the percentage of companies with weak and weak-leaning cultures has returned to pre-Enron levels. Despite some progress in 2005, the number of companies with strong ethical cultures has fallen to the historic average.”<sup>64</sup>

What is organizational culture and why is it so important to supporting ethical activities and curtailung unethical actions? According to the Ethics Resource



Center, four elements that shape ethical culture are: (1) **ethical leadership**, (2) **supervisor reinforcement**, (3) **peer commitment to ethics**, and (4) **embedded ethical values**. Studies on culture generally show that coupled with leadership, organizational culture is central to a firm's overall effectiveness and operating efficiency. As Figure 6.6 illustrates, culture is also the “glue” that holds the other organizational dimensions (strategy, structure, people, systems) together. Strong organizational cultures are possible only with strong leaders who model, build, and help sustain legal and ethical cultures through well defined and comprehensively implemented ethics and compliance programs.

## Organizational Culture Defined

A corporation's culture is the shared values and meanings its members hold in common, which are articulated and practiced by an organization's leaders. Purpose, embodied in corporate culture, defines organizations.

Corporate culture is transmitted through: (1) the values and leadership styles that the leaders espouse and practice, (2) the heroes and heroines that the company rewards and holds up as models, (3) the rites and symbols that organizations value, and (4) the way that organizational executives and members communicate among themselves and with their stakeholders.

Heroes and heroines in corporations set the moral tone and direction by their present and past examples. They are the role models; they define what is successful and attainable; they symbolize the company to outsiders and insiders; and they preserve the valued qualities of the firm, set standards of excellence, and motivate people. Enduring corporate and organizational cultural heroes include Warren Buffet at Berkshire Hathaway, Herb Kelleher at Southwest Airlines, Sam Walton at Wal-Mart, Ben Cohen and Jerry Greenfield at Ben & Jerry's, Mary Kay at Mary Kay, David Packard at Hewlett-Packard, and Bill Gates at Microsoft. Who are the heroes and heroines in your organization? By what qualities and characteristics are they remembered? Are they moral, immoral, or amoral leaders?

Rituals in companies help define corporate culture and its moral nature. Corporately sanctioned rituals that bring people together, foster openness, and promote communication can lower stress and encourage moral behavior. Social gatherings, picnics, recognition ceremonies, and other company outings where corporate leaders are present and values, stories, problems, accomplishments, and aspirations are shared can lead to cultures that value people and the company's aims. Does ethics matter for an organization's survival and market effectiveness? The “good management hypothesis” suggests that there is a positive relationship between a corporation's performance and how it treats its stakeholders. Studies confirm this hypothesis.<sup>65</sup>

**Observing Organizational Culture** Organizational cultures are both visible and invisible, formal and informal. They can be studied by observation, by listening to and interacting with people in the culture, and in the following ways:

- Studying the physical setting
- Reading what the company says about its own culture

- Observing and testing how the company greets strangers
- Watching how people spend time
- Understanding career path progressions
- Noting the length of tenure in jobs, especially for middle managers
- Observing anecdotes and stories

How ethical is your organizational or company culture using these methods?

**Traits and Values of Strong Corporate Cultures** Strong corporate cultures: (1) have a widely shared philosophy, (2) value the importance of people, (3) have heroes (presidents and products) that symbolize the success of the company, and (4) celebrate rituals, which provide opportunities for caring and sharing, for developing a spirit of “oneness” and “we-ness.”<sup>66</sup> From a stakeholder management view, organizational systems are aligned along the purpose, ethical values, and mission of the company. Also, individuals and teams in ethical cultures demonstrate a tolerance and respect for individual differences, compassion, ability to forgive and accept, and freedom and courage to do the right thing in questionable situations. As noted above, the Ethics Resource Center survey showed that “the effect of enterprise-wide cultural approach is very significant. Misconduct cut by three-fourths. Retaliation virtually eliminated. Ethics risk profile in companies with strong cultures shows no misconduct posing severe or high risk.”<sup>67</sup> Moreover, the same survey concluded that “Twenty-four percent of employees observe misconduct in strong cultural environments—three-fourths fewer than in weak cultures (98 percent), and well below the national average. Only three percent of employees working in companies with strong ethical cultures who reported misconduct experienced retaliation as a result, compared to the 39 percent who experienced retaliation in weak cultural environments.”<sup>68</sup> As discussed below, fear and retaliation prevent reporting of illegal and unethical acts by employees.

Corporate values statements serve as the economic, political, social, and ethical compasses for employees, stakeholders, and systems. Two classic benchmark values statements are those of Johnson & Johnson (Figure 6.3) and Borg-Warner (Figure 6.4). Seattle-based Boeing Corporation’s values were first articulated by its former CEO William Allen. These values still serve as an outstanding example at the individual level. They are:<sup>69</sup>

- Be considerate of my associates’ views.
- Don’t talk too much . . . let others talk.
- Don’t be afraid to admit that you don’t know.
- Don’t get immersed in detail.
- Make contacts with other people in industry.
- Try to improve feeling around Seattle toward the company.
- Make a sincere effort to understand labor’s viewpoint.
- Be definite, don’t vacillate.
- Act—get things done—move forward.

## High-Ethics Companies

What would a highly effective values-based organizational culture look like? Mark Pastin studied 25 “high-ethics, high-profit” firms, which at the time included Motorola, 3M, Cadbury Schweppes, Arco, Hilby Wilson, Northern Chemical, and Apple Computer. Although the list of high-ethics firms—like “built-to-last” firms—may change, the four principles that Pastin used to describe such firms serve as a benchmark for understanding ethically effective organizations:

Principle 1: High-ethics firms are at ease interacting with diverse internal and external stakeholder groups. The ground rules of these firms make the good of these stakeholder groups part of the firm’s own good.

Principle 2: High-ethics firms are obsessed with fairness. Their ground rules emphasize that the other person’s interests count as much as their own.

Principle 3: In high-ethics firms, responsibility is individual rather than collective; individuals assume responsibility for the firm’s actions. The ground rules mandate that individuals are responsible for themselves.

Principle 4: The high-ethics firm sees its activities as having a purpose, a way of operating that members of the firm value. And purpose ties the firm to its environment.<sup>70</sup>

Many of the FoEs (firms of endearment) discussed at the beginning of this chapter demonstrate these principles, e.g., Amazon, Costco, New Balance, IKEA, eBay, LL Bean, Wegmans, Google, Patagonia, Harley-Davidson, and REI, to name a few.

## Weak Cultures

What about companies that are not ethical? Companies that reinforce secrecy, hidden agendas, and physical settings that isolate executives from managers and employees and emphasize status over human concern often are cultures in trouble. Troubled corporate and organizational cultures can breed and encourage unethical activities, as illustrated by Enron, WorldCom, Adelphia, Arthur Andersen, and so many other firms that have been involved in corporate scandals. Figure 6.7 shows results of the ERC ethical risk behaviors in weak cultures, i.e., cultures that have poor ethical leadership, supervisor reinforcement, peer commitment to ethics, and embedded ethical values.

Organizations that also over-stress hypercompetition, profit-at-any cost, and singular economic or introverted self-interest over stakeholder obligations, and that have no moral direction, often have cultures in trouble. Signs of cultures in trouble, or weak cultures, include the following:<sup>71</sup>

- An inward focus.
- A short-term focus.
- Morale and motivational problems.
- Emotional outbursts.
- Fragmentation and inconsistency (in dress, speech, physical settings, or work habits).
- Clashes among subcultures.

Figure 6.7

## Ethical Risks for Businesses with Weak Cultures

### Severe Risk

1. Lying to employees
2. Abusive behavior
3. Discrimination
4. Lying to stakeholders
5. Misreporting hours worked
6. Safety violations
7. Putting own interests ahead of organization
8. Improper hiring practices
9. Sexual harassment

10. Stealing/Provision of low-quality goods and services
11. Environmental violations
12. Internet abuse
13. Misuse of confidential organization information
14. Alteration of financial records

### High Risk

15. Bribes/Alteration of documents

**SOURCE:** Permission granted from ERC (Ethical Resource Center), National Business Ethics Survey, 2007, p. 11. Ethics Resource Center, 2345 Crystal Drive, Suite 201, Arlington, VA 22202, U.S.

- Ingrown subcultures.
- Dominance of subculture values over shared company values.
- No clear values or beliefs about how to succeed in business.
- Many beliefs, with no priorities about which are important.
- Different beliefs throughout the company.
- Destructive or disruptive cultural heroes, rather than builders of common understanding about what is important.
- Disorganized or disruptive daily rituals.

Malcolm S. Salter, Harvard Business School professor, described Enron's culture the following way:

Enron is a case about how a team of executives, led by Ken Lay, created an extreme performance-oriented culture that both institutionalized and tolerated deviant behavior. It's a story about a group of executives who created a world that they could not understand and therefore could not control. It's a story about the delinquent society—and I use that phrase intentionally—that grew up around the company, and here I'm referring to the collusion of Enron's various advisors and financial intermediaries. And most importantly, Enron is a story about how fraud is often preceded by gross incompetence: where the primary source of that incompetence is inexperience, naiveté, an ends-justify-the-means attitude toward life, and so on. And most importantly, an inability to face reality when painful problems arise.<sup>72</sup>

A values-based stakeholder management approach would assess an organization's values with these questions: Do the leaders and culture embody "high-ethic" or "in trouble" characteristics in their values, actions, and policies? Are the values written down? Do others know the values? Do the values reflect a concern for and obligation toward the organization's stakeholders? Do the values reflect a utilitarian, just, dutiful, or egotistical ethic? Are the values taken at "face value" only, or are they practiced and implemented by employees? Do the values and communication patterns promote moral, immoral, or amoral behavior?

## 6.3 LEADING AND MANAGING STRATEGY AND STRUCTURE

If culture is the glue that holds organizations together, strategy maps the direction. The moral dimensions of strategy are also based on ethics. People are motivated to implement strategies that they believe in, are able to enact, and that produce results. Strategy and the strategy development process are the domain of organizational leaders. Gary Hamel, a contemporary strategy guru, calls for a “revolution” in leading the strategy innovation process. He states that “you need a set of values that will set you apart from the courtiers and wannabes.” Those values include “honesty, compassion, humility, pragmatism, and fearlessness.”<sup>73</sup> The strategy-making process also involves stakeholder management. A corporation’s strategy is propelled and supported by its people, stakeholders, culture, and moral contributions to its communities, customers, and society. Strategic thinking has evolved from a mechanistic process to a more holistic process, which emphasizes innovation, generation of value for stakeholders and stockholders, involvement and learning with stakeholders, and building customer partnerships and relationships.<sup>74</sup> This section and the next discuss the relationships between corporate strategy, structure, culture, systems, and moral responsibility. How do strategy and structure influence the moral behavior of employees?

Corporate leaders are responsible for orchestrating the development and execution of strategy. An organization’s strategy influences legality, morality, innovation, and competitiveness in the following ways:

1. Strategy sets the overall direction of business activities. Enterprise strategy, for example, can emphasize revenue and growth over customer satisfaction or product quality. It can drive technical concern over professional development. Corporate strategy can also direct a firm’s activities toward social issues, employee rights, and other stakeholder obligations. It can include or exclude stakeholders and employees. It can innovate recklessly for the short term or in long-term ways that benefit society as well as a few market niches.
2. Strategy reflects what management values and prioritizes. It mirrors management’s ethics and morality. It is the message to the messengers. Strategy says: “We care and value your feedback, safety, and concerns,” or “We only want your money and participation in our profits.”
3. Strategy sets the tone of business transactions inside the organization. Reward and control systems reflect the values of the larger strategic direction. An emphasis on profit at the expense of employee development is usually reflected as rigid and unrealistic incentive and revenue quota systems. Growth and expansion can be made a priority at the expense of talent development and contribution.

Marianne Broadbent, a leading scholar in information technology, offers the following insights about strategy.

When creating a strategy, I see a number of steps: the aspiration, the big business principles or maxims, then having a number of scenarios or options which are based on a set of strategic assumptions that you constantly, constantly pick to see if they are in sync. And then you use that information to shift and change. At a

tactical level, that means rolling out products and services in a very careful, risk-managed way so that you can sense and respond to the marketplace.

Strategy is very much about synchronizing the enterprise with its external environment as much as possible. Think about how increasingly interconnected economies, markets, technology and political situations are. September 11 is a great example of how quickly things can change and how interdependent logistics, for example, is with strategy, with customer service, with the politics of what's going on at the moment. I look at strategy more as synchronization, and that which focuses much more on what we call the market inputs rather than the outputs.<sup>75</sup>

From a values-based stakeholder management approach, the strategy development and implementation process should reflect the vision and mission of the organization. As with the Levi Strauss' values and vision statement in Figure 6.2, the strategy would be reviewed from these statements: "Integrity—Doing the Right Thing. Ethical conduct and social responsibility characterize our way of doing business. We are honest and trustworthy. We do what we say we are going to do. Integrity includes a willingness to do the right thing for our employees, brands, the company and society as a whole, even when personal, professional and social risks or economic pressures confront us. This principle of responsible commercial success is embedded in the company's experience. It continues to anchor our beliefs and behaviors today and is one of the reasons consumers trust our brands. Our shareholders expect us to manage the company this way. It strengthens brand equity and drives sustained, profitable growth and superior return on investment. In fact, our experience has shown that our 'profits through principles' approach to business is a point of competitive advantage."

A firm should identify issues that affect its stakeholder obligations and relationships while developing strategies. From a social and moral perspective, managers should be concerned about fulfilling their internal stakeholder obligations through these strategies. Responsible corporations must be prepared to equitably and justly enable the workforce with new technical skills and integrate aging employees, dual-career families, and new immigrants. Flexible work times, health care programs, and flexible management styles must be implemented to manage this changing workforce responsibly.

## Organizational Structure

Structure is another organizational dimension, shown in Figure 6.6, along with strategy and culture, that is part of an organization's infrastructural makeup. Ask to see almost any organization's structure and you will be handed a hierarchical set of boxes connected by lines. This so-called pyramid, or functional structure, is one of the oldest forms of depicting arrangements in companies.

Regardless of the specific type of structure, from an ethical, values-based stakeholder management perspective, key concerns and questions regarding any structure are:

- How centralized or decentralized are the authority, responsibility, communication, and information flow?
- How organic (less structured) or mechanistic (more structured) are the systems?

- How tall (more layers of bureaucracy) or flat are the reporting systems?
- How formal or informal are procedures, rules, and regulations?
- How much autonomy, freedom, and discretion do internal stakeholders and decision makers have?
- How flexible, adaptable, and responsive are systems and professionals to responding to internal and external threats, opportunities, and potential crises?

Although there are no absolute guidelines regarding which structure is more immune to or leads to ethical problems, the following overview provides some evidence about how structure relates to ethical behavior. Functionally *centralized* structures can encourage lack of communication, coordination, and increased conflict because each area is typically separated by its own boundaries, managers, and systems. Infighting over budgets, “turf,” and power increase the likelihood of unethical, and even illegal, activities. For example, post–September 11, 2001, reports show the overly centralized CIA and FBI communicated poorly with each other, with the White House, and with other systems of government.

On the other hand, highly supervised employees in bureaucratic firms may also act more ethically than employees in entrepreneurial, laissez-faire firms because employees tend to think through the risk of getting caught in firms with more supervised structures. A study conducted by John Cullen, Bart Victor, and Carrol Stephens<sup>76</sup> reported that a sub-unit’s location in the organizational structure affects its ethical climate: At a savings and loan association and also at a manufacturing plant, the employees at the home offices reported less emphasis on laws, codes, and rules than did the employees at the branch offices. Perhaps control by formal mechanisms becomes more necessary when direct supervision by top management is not feasible.

There is evidence that *decentralized* structures can encourage more unethical behavior among employees than more supervised, controlled structures. Citicorp’s credit card processing division illustrated the relationships among organizational structure, competitive pressures, and immoral and illegal behavior. The bank fired the president and 11 senior executives of that division because they fraudulently overstated revenue by \$23 million for two years. The inflating of revenue by division employees may have been related to the fact that employee bonuses were tied to unrealistic revenue targets. Citicorp centralized its organizational functions. In this case, the decentralized structure left the bank susceptible to potential abuse by employees. On the other hand, some decentralized structures may enable individually responsible and ethical professionals to communicate their beliefs and report errors faster up and down a more fluid chain of command.

Pressures from upper-level managers who overemphasize unrealistic quarterly revenue objectives and who give unclear policies and procedures to guide ethical decision making may also contribute to immoral behavior in more decentralized structures. There is evidence to support the argument that middle- and lower-level managers, in particular, feel pressured to compromise their personal moral standards to meet corporate expectations.<sup>77</sup>

Managers in large firms may compromise their personal ethics to meet corporate expectations for several reasons, which include:

1. Decentralized structures with little or no coordination and central policy and procedures encourage a climate for immoral activities when pressures for profit-making increase.
2. Unrealistic short-term and bottom-line profit quotas add pressure on employees to commit unethical actions.
3. Overemphasis on numbers-driven financial incentives encourages shortcuts.
4. Amoral organizational and work-unit cultures can create an environment that condones illegal and immoral actions.

## Boundaryless and Networked Organizations

The decentralization of organizations has been accelerated by information technology and the re-engineering of business processes. Software applications and Web-enabled intranets and extranets allow the boundaries within organizations and between customers and companies to become more transparent and fluid.<sup>78</sup> Dell Computer has eliminated middle layers of its company, supply chain, and industry by enabling individual customers to design, order, and purchase—and even receive, in the case of software—their own customized computer products online. These changes are not easy, nor are they isolated from the larger context of the organization. An organizational expert<sup>79</sup> noted that the main reason implementation of major technology changes fails is that “the technology was seen as the solution, without taking into account the complex dynamic of the organization and people. It doesn’t matter in which area, whether it’s knowledge management or B2B. You can’t forget that organizations are made of people and technology, and both people and technology will define the success of an organization.”

From both an ethics and efficiency perspective, care should be taken by companies implementing digital networks, because one study<sup>80</sup> reported that digital networks generate both opportunities for and threats to worker autonomy. Major opportunities include increased communication capabilities, “informedness,” and “teleworking.” Threats to worker autonomy are electronic monitoring, dependence on third-party operators and managers, and task prestructuring, which can reduce individual responsibility and control. These opportunities and problems depend, in part, on the type of organizational structure in place: how open and responsive it is or how closed and vulnerable it may be to unethical activities.

## 6.4 LEADING AND BALANCING INTERNAL STAKEHOLDER VALUES IN THE ORGANIZATION

The other internal dimensions of organizations, illustrated in Figure 6.6, should also be aligned in order for the organization to succeed in meeting its goals and social responsibility obligations.



In practice, aligning an organization's values and mission with its internal stakeholders, while treating external groups and organizations ethically, is difficult because of competing values of internal stakeholders. The following quote from Anderson<sup>81</sup> illustrates the diversity among stakeholder values:

An organization in almost all its phases is a reflection of competing value choices. Owners want a return on their investment. Employees want secure jobs and career development. Managers want growth and industry leadership. Government regulators want minimal pollution, safety, work opportunities for a wide variety of groups, and tax revenues. For top managers, this competition comes to a head because they must unravel complex problems whose solutions benefit some groups but have negative consequences for others. Framing these decisions inevitably leads to some crucial dilemmas for managers, who must answer the broad question, "What is a convincing balance among competing value choices?"

R. Edward Freeman and Daniel Gilbert Jr. argued that we must understand the multiple and competing values underlying stakeholders' actions in order to understand the choices corporations make.<sup>82</sup> Balancing internal stakeholder interests can be difficult because of the diversity of professional and functional backgrounds, training, goals, time horizons, and reward systems. These differences are further influenced by organizational politics, the constraints and pressures of other internal systems, and changing roles and assignments. Figure 6.8 is an example of an organization's internal stakeholders and competing professional value orientations.

Function orientations such as marketing, research and development, production, information systems, and finance have built-in competing values, especially when employees who are under pressure must design, deliver, and service complex products and services for demanding customers. Marketing and sales professionals work with short- to medium-term time horizons and are rewarded on the basis of their results. Sales professionals, in particular, have a very short time horizon and depend on the success of individual and team selling ability to satisfy, retain, and attract customers. Research and development (R&D) professionals generally have a longer time horizon and are rewarded for their innovations.

Contrast, for example, marketing and sales professionals with R&D professionals, as shown in Figure 6.8, and you can see how value differences and role conflicts can occur within cross-functional teams. Competition and conflict can lead to higher productivity and also to unethical decisions and practices such as producing unsafe products or lying to customers to make a sale.

From a stakeholder management perspective, it is the role of an organization's leaders, with the support of each professional, to ensure that the internal integrity and market effectiveness of a company is based on the types of relationships and values that embody trust, collaboration, and a "win-win" goal for stakeholders and stockholders. Amorally and unethically led and managed organizations with conflicting internal values can, and sometimes do, lead to illegal situations. Interpersonal communication skills, conflict resolution, and collaborative negotiation methods (as exemplified in Chapter 2) are also needed to help integrate these functional area differences.

Figure 6.8

### A Functional Profile of Internal Organizational Stakeholders: Professional Orientations

Professional Stakeholders					
Orientations	Marketing & Sales	Research & Development (R&D)	Production	Finance & Accounting	Information Systems
<b>Background</b>	Liberal arts; social sciences; entrepreneurial; technical	Electrical engineering; technical	Mechanical engineering; operations	Finance; accounting; auditing; tax	Software “engineers”; data management; programming
<b>Goals and “Stakes”</b>	High product mix; revenue and market competitiveness; customer satisfaction	Market dominance; innovation; competitiveness	Product yield; quality control	Low-cost capital; efficient borrowing; accountability	Problem solving; organizational integration; systems functioning
<b>Focus and Rewards</b>	Product or service leadership; creative autonomy; bonuses; equity; career mobility	Next “killer” application; resources to innovate; prestige	Product lifecycle stability; peace with R&D job security; bonuses	Low costs; high yields; data access; accuracy; cooperation; career advancement	Satisfied users; state-of-art technology; career advancement; new skill development
<b>Time Horizon</b>	Short to medium time frame	Medium to long time frame	Short to continuous time frame	Continuous time frame	Continuous time frame

**SOURCE:** Copyright Joseph W. Weiss, Bentley College, Waltham, MA, 2009.

Value and innovation are created when the collaborative efforts of an organization’s systems create synergy. The organization’s vision, values, and mission, which are reinforced by the culture and example of the leaders, are the cornerstone for integrating structures and systems. Following this logic, W. Chan Kim and Renee Mauborgne<sup>83</sup> posed the following research question: “What type of organization best unlocks the ideas and creativity of its employees to achieve this end?” They discovered that “when putting value innovation strategies into action, structural conditions create only the potential for individuals to share their best ideas and knowledge. To actualize this potential, a company must cultivate a corporate culture conducive to willing collaboration.”<sup>84</sup>

These authors describe “the positively reinforcing cycle of fair process” as one which creates innovative outcomes for companies. They describe this process as follows: For each success a group has in implementing a “general value innovation strategy” based on fair process, the result strengthens the group’s cohesiveness and their belief in the process. This, in turn, sustains

the collaboration and creativity inherent to value innovation. The four components of that process include:<sup>85</sup>

1. Engagement, explanation, expectation, clarity.
2. Idea sharing and voluntary cooperation.
3. Value innovation plans and rapid execution.
4. Organizational confidence in and respect for colleagues' intellectual and emotional worth.

## 6.5 CORPORATE SELF-REGULATION AND ETHICS PROGRAMS: CHALLENGES AND ISSUES

According to the ethicist Lynn Paine in a *Harvard Business Review* article,<sup>86</sup> a values-based approach in ethics programs should be more effective than a strict, rules-based compliance approach since a values approach is grounded and motivated in personal self-governance. Employees are more likely to be motivated to “do the right thing” than threatened if they violate laws and rules. A values-based stakeholder management approach assumes that corporations (owners and management) ought to intrinsically value the interests of all stakeholders.<sup>87</sup> In practice, this is not always the case.<sup>88</sup> Later studies suggest that both values-based and compliance ethics programs seem to work effectively together. Without values-based compliance, however, compliance and fear-based programs are less likely to succeed.<sup>89</sup> Responsible self-regulation in companies can enhance entrepreneurship and reduce unnecessary costs of too much bureaucratic control (e.g., it is estimated that Sarbanes-Oxley costs large public companies \$16 million to implement). One study by the Open Compliance Ethics Group (OCEG) found that firms that had an ethics program for ten or more years did not have “reputational damage” during the last five years. Ethics programs appear to have some intended effect.<sup>90</sup> Complete your company’s “ethical weather report” (Figure 6.9) to identify your point of view regarding how ethical your company is.

Chapter 4 discussed in more detail ethics programs that include codes of ethical and legal conduct that are designed to help companies financially and legally. As noted in Chapter 4, the federal sentencing guidelines for organizations (FSGO) were established in 1984 by Congress—which passed a crime bill that instituted the U.S. Sentencing Commission. This commission, made up of federal judges, was empowered with sentencing those found in violation of the guidelines. In 1987, uniform guidelines were created for sentencing individuals in the federal courts. Some federal judges quit the bench in protest of the strictness of the guidelines and the sentences they were required to hand down. In 1991, the commission shifted the emphasis from individual wrongdoers to organizations that might be found guilty for the illegal actions of their employees. The 1991 guidelines threaten fines of up to \$290 million to companies found guilty of violating the federal guidelines. However, those fines can be substantially reduced if an organization implements an “effective program to prevent and detect violations of law.” Companies that followed the requirements of the FSGO could find relief

from lawsuits that resulted from one or more criminally motivated professionals. However, without active, ethical leadership, there is less likely to be a strong culture, open communication, and support from other organizational systems to support ethics programs.

### Figure 6.9

## Ethical Weather Report

**Step 1:** Complete the following questionnaire using the organization in which you are working or one in which you have worked. Beside each statement, write the number from the scale that accurately reflects your knowledge and experience with the company.

Completely False 0	Mostly False 1	Somewhat False 2	Somewhat True 3	Mostly True 4	Completely True 5
_____	1.	In this company, people are expected to follow their own personal and moral beliefs.			
_____	2.	People are expected to do anything to further the company's interests.			
_____	3.	In this company, people look out for each other's good.			
_____	4.	It is very important here to follow strictly the company's rules and procedures.			
_____	5.	In this company, people protect their own interests above other considerations.			
_____	6.	The first consideration is whether a decision violates any law.			
_____	7.	Everyone is expected to stick by company rules and procedures.			
_____	8.	The most efficient way is always the right way in this company.			
_____	9.	Our major consideration is what is best for everyone in the company.			
_____	10.	In this company, the law or ethical code of the profession is the major consideration.			
_____	11.	It is expected at this company that employees will always do what is right for the customer and the public.			

**Step 2:** Score your answers by adding up your responses to 1, 3, 6, 9, 10, and 11. Write the sum under Subtotal 1 below. Now reverse the scores on questions 2, 4, 5, 7, and 8 (5 = 0, 4 = 1, 3 = 2, 2 = 3, 1 = 4, 0 = 5). Add these reverse scores (i.e., number value) and write the sum in Subtotal number 2. Now add Subtotal 1 with Subtotal 2 for your overall score. The total score ranges between 0 and 55. The higher the score, the more the organization supports ethical behavior.

Subtotal 1 \_\_\_\_\_ + Subtotal 2 \_\_\_\_\_ = Overall Score \_\_\_\_\_

**Step 3:** Write a paragraph explaining your organization's ethical profile: Why is it the way it is? Offer specific steps you would recommend in your organization's cultural dimensions, leadership, policies, or procedures that would either enhance its already ethical climate or help change the climate.

**SOURCE:** Reprinted from *Organizational Dynamics*, Autumn/1989, J.B. Cullen, B. Victor, C. Stephens, An Ethical Weather Report Assessing the Organization's Ethical Climate, © 1989, with permission from Elsevier.

## Organizations and Leaders as Moral Agents

Since corporations are charted as citizens of states and nations, they also share the same rights and obligations as citizens. Corporations are not, however, individuals; they are moral agents that must follow laws, rules, and regulations of their local and national settings. When corporations violate such laws they are also subject to penalties and fines, and can even have their right to exist taken away, depending on judicial findings in criminal acts (as was the case with the Arthur Andersen firm). The role of leaders as moral agents has not been emphasized enough as one of the key ingredients in building and sustaining ethics programs; organizational leaders who lack strong moral character and convictions, even if they are brilliant strategists and execute excellently, leave their firms vulnerable to illegal and unethical acts, as Enron clearly showed.

## Ethics Codes

Ethics codes are value statements that define an organization. Leaders' values again play a significant role in shaping the values of the organizations which they serve. Six core values that researchers have found desirable in such codes include: (1) trustworthiness, (2) respect, (3) responsibility, (4) fairness, (5) caring, and (6) citizenship.<sup>91</sup> Johnson & Johnson's Credo (Figure 6.3) is an outstanding example. Raytheon, Fidelity, and Honda and other firms in the FoE list in this chapter have ethics and codes of conduct that are noteworthy. Major purposes of ethics codes include:<sup>92</sup>

- To state corporate leaders' dominant values and beliefs, which are the foundation of the corporate culture.
- To define the moral identity of the company inside and outside the firm.
- To set the moral tone of the work environment.
- To provide a more stable, permanent set of guidelines for right and wrong actions.
- To control erratic and autocratic power or whims of employees.
- To serve business interests (because unethical practices invite outside government, law enforcement, and media intervention).
- To provide an instructional and motivational basis for training employees regarding ethical guidelines and for integrating ethics into operational policies, procedures, and problems.
- To constitute a legitimate source of support for professionals who face improper demands on their skills or well-being.
- To offer a basis for adjudicating disputes among professionals inside the firm and between those inside and outside the firm.
- To provide an added means of socializing professionals, not only in specialized knowledge, but also in beliefs and practices the company values or rejects.

## Codes of Conduct

An organization's code of conduct is only as credible as the CEO's and leaders' personal and professionals codes of conduct. Leaders must "walk the walk" as well as "talk the talk." "An organization's code of conduct,

alternatively referred to as ‘code of ethics’ or ‘code of business standards,’ is the stated commitment of the behavioral expectations that an organization holds for its employees and agents. Such codes are now commonplace for most corporations and are increasingly shared not only with employees, but also with customers and the public at large. To be successful, a code must be believable by all stakeholders to which it applies. A corporation’s leaders must show commitment to communication and fairly enforcing codes of conduct for such documents to be effective. However, how the code is written and what it contains are also important elements regarding whether it has the power to influence not only perceptions, but actions.<sup>93</sup> One survey of U.S. corporate ethics codes found that the most important topics were general statements about ethics and philosophy; conflicts of interest; compliance with applicable laws; political contributions; payments to government officials or political parties; inside information; gifts, favors, and entertainment; false entries in books and records; and customer and supplier relations.<sup>94</sup> Notable firms go further in detailing corporate obligations. The examples of Johnson & Johnson and Borg-Warner (Figures 6.3 and 6.4) define their obligations to various stakeholders. Other exemplary codes include those of General Electric, KMPG, PricewaterhouseCoopers, Boeing, General Mills, GTE, Hewlett-Packard, McDonnell Douglas, Xerox, Norton, Chemical Bank, and Champion International.

Examples of items in a code of conduct include the following:<sup>95</sup>

- Financial Integrity & Assurance
- Ethical Principles
- Intellectual Property
- Information Security
- Workplace Violence
- Insider Trading
- Illegal Business Practices
- OSHA (Occupational Safety and Health Administration) guidelines
- Legal & Effective Email
- Anti-Money Laundering
- Conflicts of Interest
- Health & Safety
- Harassment
- Record Keeping & Destruction
- Gifts & Gratuities
- Antitrust
- Diversity

Companies looking to buy (acquirers) other companies (targets) perform preacquisition due diligence on the management, finance, technology, services and products, legality, and ethics of the targets. That is, companies looking to purchase other companies need to perform analyses to discover if the targets are telling the truth about their products, finances, and legal records. “Where does one start in uncovering the ethical vulnerability of a target?” The following basic questions are suggested as a starting point:<sup>96</sup>

1. Does the target have a written code of conduct or code of ethics?
2. Does the company provide ethics training or ethics awareness-building programs for management and company employees?
3. Are avenues, such as an ethics office or hotline, available for employees to ask questions about ethical issues?

## Problems with Ethics and Conduct Codes

The problems with corporate ethics codes in general are the following:<sup>97</sup>

1. Most codes are too vague to be meaningful, i.e., the codes do not inform employees about how to prioritize conflicting interests of distributors, customers, and the company. What does being a “good citizen” really mean in practice?
2. Codes do not prioritize beliefs, values, and norms. Should profit always supersede concern for customers or employees?
3. Codes are not enforced in firms.
4. Not all employees are informed of codes.
5. Codes do not relate to employee’s actual work and ethical “gray” areas.
6. Top level leaders in organizations usually do not show interest or involvement in the programs.
7. Codes do not inspire or motivate employees to follow law, rules, and procedures.
8. Codes that are used internationally have sections that are irrelevant or incomplete to other country personnel’s experiences and specific areas of concern.

Ethics codes are a necessary but insufficient means of assisting or influencing professionals with managing moral conduct in companies. One study<sup>98</sup> showed that companies that had corporate ethics codes had “less wrongdoing and higher levels of employee commitment.” However, the authors explained that “formal ethical codes are one component of a milieu that encourages and supports high standards of ethical behavior; that is, these organizations have formal and informal mechanisms to ensure that ethical conduct becomes ‘a way of life.’” Also, employee behavior was not as influenced by the ethics codes because the codes “are not part of the organizational environment.” Part of the message here may also be that implementing several organizationally supported and integrated values-based stakeholder management and ethics programs has a better chance of meeting intended goals than does reliance on brochures and printed documents.

## Ombuds and Peer Review Programs

Ombuds and peer review programs are additional methods that corporations use to manage the legal and moral aspects of potentially problematic activities in the workplace. The ombuds approach provides employees with a means of having their grievances heard, reviewed, and resolved. Originating in Sweden, this concept was first tried at Xerox in 1972 and later at General Electric and Boeing. Ombuds individuals are third parties inside the corporation to whom employees can take their grievances. At Xerox, employees are encouraged to solve their problems through the chain of command before seeking out the ombudsperson. However, if that process fails, the employee can go to the ombudsperson, who acts as an intermediary. The ombuds individuals, with the employee’s approval, can go to the employee’s manager to discuss the grievance.

The ombudsperson can continue through the chain of command, all the way to the president of the corporation, if the problem has not been satisfactorily resolved for the employee. Ombudspersons have no power themselves to solve disputes or override managers' decisions. Complaints usually center on salary disputes, job performance appraisals, layoffs, benefits, and job mobility. At General Electric, ombudspersons report that they handle 150 cases every year.

An example of an effective ombuds program is that of the International Franchise Association (IFA). Its board of directors adopted a comprehensive self-regulation program that has a clearly, strongly stated ethics code, an investor awareness and education program, a franchise education compliance and training program, a code enforcement mechanism, and an ombudsperson program, which is described as follows: "The ombudsperson program is designed to enable franchisors and franchisees to identify disputes early and to assist them in taking preventative measures . . . facilitating dispute resolution . . . recommending non-legal methods and approaches to resolving disputes, encouraging [both parties] to work together to resolve disputes, providing confidentiality throughout the process, and providing objective and unbiased advice and guidance to all the participants."<sup>99</sup>

A problem with the ombuds approach is that managers may feel their authority is threatened. Employees who seek out ombudspersons also might worry about their managers retaliating against them from fear or spite. Confidentiality also has to be observed on the part of ombudspersons. The ombudsperson is as effective as the support of the program by stakeholders allows him or her to be. An ombudsperson's success is measured by the trust, confidence, and confidentiality he or she can create and sustain with the stakeholders. Finally, the ombudsperson's effectiveness depends on the acceptance by managers and employees of the solutions adopted to resolve problems.

Ombuds programs have, for example, been successful at IBM, Xerox, General Electric, the U.S. Department of Education, Boeing, and several major U.S. newspaper organizations.<sup>100</sup>

The *peer review panel* is another program that more than 100 large companies have used to enable employees to express and solve grievances, thus relieving stress that could lead to immoral activities. Employees initially use the chain of command whenever a problem exists. If the supervisors or executives do not resolve the problem, the employee can request a peer review panel to help find a solution. Two randomly selected workers in the same job classification are chosen for the panel along with an executive from another work unit. The selection must be reviewed in reference to company policy. Peer review panels work when top management supports such due process procedures and when these mechanisms are perceived as long-term, permanent programs.

Peer review programs have received positive reviews and have had good results, particularly in the health care and accounting industries. More than 50% of the U.S. state boards of accountancy require certified public accountants to participate in a peer review program to obtain a license to practice.<sup>101</sup> Congress has mandated the use of the Medicare Peer Review



Organization since 1982.<sup>102</sup> In England, peer review accreditation programs have evolved as external voluntary mechanisms that also provide organizational development of health care providers.<sup>103</sup> Ombudsperson and peer review programs serve as popular mechanisms not only for solving disputes among stakeholders, but also for integrating the interests of diverse stakeholders.

We conclude this chapter by summarizing a “Readiness Checklist” organizations can use to determine whether or not their executives and professionals use a values-based stakeholder management approach to create and sustain integrity in the organization. If not, they may review their vision, mission, values statements as well as their ethics and codes of conduct. You may consider applying the checklist to your organization or institution.

### **Is the Organization Ready to Implement a Values-Based Stakeholder Approach? A Readiness Checklist**

A values-based stakeholder readiness checklist can inform and educate (even interest and mobilize) top level leaders to evaluate the ethics of their business practices and relationships. The following readiness checklist is an example that can be modified and used as a preliminary questionnaire for this purpose:

1. Do the top leaders believe that key stakeholder and stockholder relationship building is important to the company’s financial and bottom-line success?
2. What percentage of the CEO’s activities is spent in building new and sustaining existing relationships with key stakeholders?
3. Can employees identify the organization’s key stakeholders?
4. What percentage of employee activities is spent in building productive stakeholder relationships?
5. Do the organization’s vision, mission, and value statements identify stakeholder collaboration and service? If so, do leaders and employees “walk the talk” of these statements?
6. Does the corporate culture value and support participation and open and shared decision making and collaboration across structures and functions?
7. Does the corporate culture treat its employees fairly, openly, and with trust and respect? Are policies employee-friendly? Are training programs on diversity, ethics, and professional development available and used by employees?
8. Is there collaboration and open communication across the organization? Are openness, collaboration, and innovation rewarded?
9. Is there a defined process for employees to report complaints and illegal or unethical company practices without risking their jobs or facing retribution?
10. Does the strategy of the company encourage or discourage stakeholder respect and fair treatment? Is the strategy oriented toward the long or short term?

11. Does the structure of the company facilitate or hinder information sharing and shared problem solving?
12. Are the systems aligned along a common purpose or are they separate and isolated?
13. Do senior managers and employees know what customers want, and does the organization meet customer needs and expectations?

If answers to these questions are mostly affirmative, the internal organization most likely reflects ethical leadership, culture, and practices. If responses are mostly negative, legal and ethical problems may be imminent.

## CHAPTER SUMMARY

Corporate and organizational leaders set the vision, mission, and values of their enterprises. Leaders also help define the culture of companies that determine their firms' ethical and legal boundaries and contributions. A stakeholder management, values-based approach is central to organizing and aligning internal systems to respond to all stakeholders. There are still many lessons to be found in the classic "built-to-last" and "good to great" companies whose fundamental purposes and core values were the foundation for competitive long-term achievement. More recently, highly successful companies referred to "firms of endearment" exemplify even more of a values-based, stakeholder approach in dealing with customers, employees, suppliers, vendors, and society. This chapter offered numerous examples and evidence of effective values and stakeholder management approaches leaders use in the marketplace.

Leaders define and model the moral character of organizations. Leaders guide the identification of a vision, mission, and values and then serve as ethical role models in their stakeholder and business relationships. Figure 6.1 illustrates a strategic alignment model that leaders can use to guide their strategy development process. James Collins' "Level 5" leader profile was used as an example of successful leaders. A values-based stakeholder management approach was summarized and argued that organizations can be economically successful by being socially responsible and ethical with their stakeholders.

Leadership in organizations can be defined from a values-based approach: Leaders define and model the social and ethical as well as the competitive mission of companies. They build and sustain relationships with stakeholders while demonstrating collaboration and trust. Stakeholder management is the basis for strategic alliances. Former president of Southwest Airlines Herb Kelleher, Aaron Feuerstein of Malden Mills, and Jeffrey Swartz of The Timberland Company are a few examples of successful competitive industry leaders who lead ethically and spiritually.

Failure of ethical leadership is evidenced by seven symptoms: ethical blindness, muteness, incoherence, paralysis, hypocrisy, schizophrenia, and complacency. Micky Monus, former CEO of the Phar-Mor company, failed to lead ethically and was sentenced to 20 years in prison for mail fraud, wire fraud, bank fraud, and theft. "Chainsaw Al" Dunlap, former CEO of Sunbeam, was fired after the SEC found fraudulent activities during his tenure.

The reasonableness of CEO pay and performance was discussed. Not all CEOs are overpaid, but there is a significant number of highly visible CEOs whose high compensation appears unrelated to their firms' performance. This remains a concern of activist shareholders.

Figure 6.6 summarizes an alignment contingency model for understanding the “big picture” of leaders' tasks in defining and implementing effective and ethical strategies, cultures, and structures. Strategies, cultures, structures, and systems are aligned along a vision, mission, and core values. This approach is compatible with the “firms of endearment,” “built-to-last,” and “good to great” studies of successful organizations. Customers as key stakeholders are central to an organization's alignment since they are essential to a firm's success.

Strategy must be aligned with markets, values, culture, leadership style, and structure to be effective. Strategy serves both a revolutionary role (to be innovatively competitive) and a more classical role at four levels: enterprise, corporate, business, and function. Strategies influence ethics by the expectations, pressures, motivation, and rewards they create. Overly aggressive strategies, which may also be unrealistic, can create implementation pressures that lead to unethical activities.

Culture, structure, and other systems are internal dimensions that enable leaders and professionals to implement strategy. “High-ethics” company cultures can serve as a benchmark for other organizations' cultures. Such cultures are grounded in well-defined purposes that drive operations. These cultures are also modeled by leaders who are devoted to fairness, interaction with all stakeholders, concern for stakeholder interests, and individual responsibility.

Organizational structures that are overly centralized or decentralized may foster ethical problems. Although there is not “one best way” to structure a company, there are advantages and disadvantages to each type of structure. For example, centralized functional structures discourage open communication and sharing and must be integrated. Decentralized structures, such as networks and project teams with little or no coordination, may create a climate for unethical activities, such as fraud, theft, and unfair pressure of customers and alliance partners. Having leaders who rely on mission-driven ethical values that are communicated, reflected in the culture, and enforced throughout a firm is a necessary part of structural alignment.

Figure 6.8 illustrates the challenge of balancing internal organizational and professional stakeholders' values. Professional stakeholders in marketing, R&D, sales, finance, and production often function within four boundaries: rewards, time horizons, training backgrounds, and resource constraints. A critical task of organizational leaders is to guide internal professionals and focus them on the mission and values of the company.

An overview of self-regulated ethics programs was presented. Ethics programs, codes, ombudspersons, peer reviews, and ethics officers programs are ways in which corporations can attempt to regulate themselves. Johnson & Johnson's “Credo” in Figure 6.4 is an example of an outstanding ethics code.

A readiness checklist for assessing a values-based, stakeholder readiness perspective was offered that enables firms to address the extent to which they use a values-based stakeholder approach in their business practices.

## QUESTIONS

1. Describe the most ethical leader for whom you have worked. Now describe the least ethical leader. Which leader did you learn valuable lessons from and enjoy working with the most? The least? Why? What role did ethics play in your answers? Explain.
2. Describe an experience you have had (or an experience where you observed a leader) that required moral courage to either make a tough decision or refrain from making a decision that could have had harmful consequences. After describing the experience, answer these questions: (a) What was “moral” about the decision that had to be made? (b) What differentiated this situation and decision from other decisions that were serious but that did not require “moral courage”? Explain.
3. Do you believe leaders in large Fortune 500 companies follow and model their stated visions, missions, and values in everyday business dealings? Explain. Identify a Fortune 500 company and CEO in the news that demonstrates ethical behavior. Is there any evidence that his or her company’s performance is related to ethical leadership behavior? Explain.
4. Do companies have to operate ethically to be financially successful? Explain.
5. Identify some characteristics of a values-based stakeholder approach to leading and running a company. Do you agree or disagree with these characteristics? Explain.
6. Which of the 13 values-based readiness checklist steps would you expect are least practiced in most companies? Which steps on the list do you believe the organization for which you work(ed) practiced least? Why?
7. Do you believe most CEOs in U.S. companies are overpaid and underperform? Explain. What pay or performance criteria do you believe should be used for top-level officers in publicly traded companies?
8. Offer one difference a values-based, ethical stakeholder approach could make in the formulation and implementation of an organization’s strategy. Explain.
9. Suggest three differences a values-based, ethical stakeholder perspective could make in forming and building a new organizational culture. Explain.
10. What clues would you look for in identifying ethical and unethical activities by evaluating an organization’s structure? Explain.
11. If you were to evaluate the alignment of an organization’s strategy, structure, and culture from a values-based stakeholder approach, suggest three criteria you would use and some questions you would ask.
12. Which is most effective for organizational stakeholders: internal self-regulation or government regulation? Defend your points.
13. Explain the strengths and weaknesses of organizational (a) ethics codes, (b) ombuds and peer review programs, and (c) ethics departments.

## EXERCISES

1. Assume you are an ombudsperson or an ethics officer for a large organization. What problems do you believe you would experience? Why? What contributions do you think you could make in this role? Why?
2. Describe the type of training you would need and list specific competencies that would help you in the role of ombuds or ethics officer.
3. Draft a brief values statement (or list some major values) of the ideal company for which you would like to work. Compare your list with other students' lists. What similarities and differences did you find? Compare your list to the examples in this chapter. What are the similarities or differences?
4. Briefly describe the leader of an organization in which you work or have worked. Evaluate the moral, amoral, or immoral characteristics of the leader. Refer to the "ethics of leadership styles" and the "seven symptoms of the failure—or success—of leadership" in the chapter.
5. Return to question 4. Suggest specific ways that your leader could improve his or her leadership competency and ethical style.
6. Briefly describe the culture of an organization in which you work or have worked. Explain how the culture affected a specific business practice. How ethical or unethical were the effects of the culture on that business practice? Explain.
7. Return to question 6. Suggest a few ways in which that organization's culture could be strengthened or changed. Offer a suggestion for the way the strategy formulation or implementation could be changed. Offer a way in which one of the practices or management methods of the system could be changed for improvement.

## REAL-TIME ETHICAL DILEMMA

**Values and Leadership  
at Z Insurance Corp.**

**“What Would You Do?”** I graduated from the University of New England on a beautiful day in May of 2002. Graduating *cum laude*, with a job in my back pocket, I thought that my future was as bright as the sun was that day. However, unlike that beautiful day, blue skies did not lie ahead for me professionally.

During the spring of my senior year, I was busy interviewing for full-time positions after graduation. At one particular campus career fair, I came across the Z Insurance Corp. booth. As a business student, I had a keen interest in financial services. I believed and still believe that it is a noble profession, which helps to give hardworking people the power to be financially stable, save money for retirement, or put their children through college. Because of these interests, I was very curious to see what Z Corp. had to offer in the realm of financial services.

Looking back (with 20/20 hindsight), I believe that I was duped from the beginning. I'll tell you why in the following two actual scenarios.

**Scenario One: “How I Learned to Lie to the Elderly”** My grandmother is one of the most caring and wonderful people I know. Recently, my grandfather passed away and left my grandmother with a considerable amount of money, and little financial experience to manage it. She guarded the money very carefully, since it was earned by her best friend and loving husband. Back to Z Corp.

The new “recruits” at Z Corp. have a two-week-long orientation

before they can begin their work. During the first couple of days of this orientation, we watched films that illustrated how we would be helping senior citizens protect their life savings. These films had positive messages about America's senior citizens, including how to communicate with them in a respectful manner, cherish their money as if it was ours, and take each question they had with the utmost care. Although I was still a bit shocked by the fact that I was now an insurance salesperson, I was excited by the prospect of making a difference in the lives of America's senior citizens. I was picturing folks, similar to my grandmother, who would trust us to help them protect their life's hard-earned money.

These utopian ideals were soon transformed into harsh realities. Daily, I became increasingly aware of the games that this company was playing with us as well as the people that we were to “help.” On one particular day, we were discussing how we were going to “entice” our customers on the phones so that they would listen to our message about long-term care insurance. Again, we didn't know that we going to be involved in “cold calling,” which was yet another surprise to us. During this meeting, we were given our “communication,” which was to be followed very closely, not deviating from any of the scripts. While I was reading over the “communication,” something struck me as peculiar. The following is a rough sample of our “communication”:

Z Corp. Rep: “Hello, my name is Lea Stern from Z Corp. I am a financial advisor. I am calling in

(continued)

*(Continued)*

regard to literature that you received in the mail from us. Do you recall receiving this information?" (Usually the response was "No, I don't remember seeing anything from Z Corp.")

Z Corp. Rep: (chuckling) "Oh, I am sure you may not have. We all receive so much in the mail these days that you may have thrown it away or may have not read it yet."

After I read this script, I asked the sales manager whether or not these folks actually received something from Z Corp. regarding long-term care insurance. What he said in response to my question still rings clear in my head. So clear, in fact, that I am going to quote it. "These folks are old and confused. Most likely they received something in the mail about 'financial planning.' We are banking on the fact that they will not remember or realize who it was from and will take our word that it was from us."

"Old and confused" is how the sales manager described my loving grandmother. Because of the values that I grew up with and still hold, I could not imagine taking advantage of hardworking seniors in such a twisted, immoral way. With this one statement, I decided that I did not respect my manager or Z Corp. My attitude changed immediately. I knew from that moment that I would find it very hard to work for Z Corp. and almost impossible to work for that manager.

**Scenario Two: "Reading the Fine Print"** I have been blessed with a wonderful family who surrounded me with caring people who would never try to take advantage of me. Maybe I

am trusting and a bit naïve, but I'm not stupid! With the experience I described previously at Z Corp., I learned that this trust could be a double-edged sword. I lived 21 years not realizing how twisted company policies and practices could be; it took only one week at Z Corp. for me to wake up to "corporate realities"—at least in an insurance sales setting.

At the career fair at the University of New England, I had a wonderful conversation with a sales manager at Z Corp. We discussed the virtues of being a financial advisor, such as recommending appropriate mutual funds based on financial needs, careful investments, and the merits of having Series 6 and 7 licenses. I enjoyed the fact that Z Corp. seemed to be a company that helped folks invest in diversified ways. Never once were insurance sales, cold calling, or no pay for four months mentioned; not during the first, second, or final interview. Only when I signed on and was in training did I find out the truth about this shift company.

During each of the lunches on that first week of our orientation, the "recruits" discussed what we called the "footnote." We used this term because we felt there was always another footnote regarding pay, customer contact, or office supplies. I felt as if I were employed at a different company, with a completely different position than the one for which I originally interviewed. Some of this may have been my fault. For example, I never asked what the values of this company were or what its mission was. However, important points such as job function and company mission, as well as reimbursement, should be



*(Continued)*

communicated truthfully. I felt as if the people at Z Corp. did not communicate effectively with us at all. A communication channel was not established between the managers and me at Z Corp. Without proper communication, I was taken advantage of and didn't feel comfortable being in the follower role. I didn't know what the company stood for, and most importantly I didn't know what I stood for!

**Questions**

1. What are your general reactions to the two scenarios?
2. Would you react similarly or differently than the writer? Explain.
3. Do you believe the writer is naïve and that these scenarios represent the "real world" from which she has been sheltered? Or, do you think this company is a single "rotten apple" among the more honest companies in this industry and the writer should react as she did? Explain.
4. Are there any illegal or unethical tactics the company sales manager/rep is using? Explain.



## REAL-TIME ETHICAL DILEMMA



## Whose Values? Whose Decision?

Jim Howard is a sales manager at a software company that produces a search interface for databases with indexed information. The company is an established vendor and has a good reputation in the market for its high-quality products, fast and personal customer support, and strong loyalty to its customers. Part of the values statement of the company includes, “We will treat our customers with respect and dignity.”

In his first year with the company, Jim noticed that the sales force was having difficulty acquiring new customers and retaining existing ones. The problem was complex: a shrinking market with continuously increasing buying power, increasing competition, and the emergence of free alternatives from the Internet. These problems started to significantly affect the company’s revenue. The company’s reaction was to drastically decrease the cost of its products, bundle databases into packages, and start to alter product introductions by including several value-added services that were new to the market.

Jim Howard’s boss suggested that Jim take over the responsibility for the yearly renewals of customer subscriptions from the company’s secretary, which previously had been regarded as an easy clerical procedure. When he started to check the old accounts and follow up with renewals, he faced a problem that he thought would never have occurred: unfair treatment of old customers in comparison to new customers in terms of the product pricing. Existing customers were offered renewal at triple the

price of the same package and renewals offered to new customers.

When he asked his boss whether he should inform the old customer that the price had changed and whether the old customer could now benefit from the lowered price, the answer was, “Why don’t we try to get this price? If the customer refuses to pay it, then we’ll negotiate.” An additional difficulty was that, in the last few months, information had been disseminated to all customers that made the company’s new pricing strategy visible to customers. Jim shared the fact with his boss that this information was already available to customers and pointed out the contradiction. His boss remained insistent, to the point of shouting, that Jim follow his previous instructions with the sales force.

Jim felt he was betraying the company, the customer, his sales force, and his own professional values. He didn’t want to lose his job, and he didn’t want to lose any more customer accounts.

### Questions

1. If you were Jim, what would you do in this situation?
2. What are the issues here? For whom?
3. Who stands to be hurt the most from following the advice of Jim’s boss?
4. What would a values-based stakeholder management approach suggest that you do, if you were Jim? Lay out an action plan and be ready to role-play your suggested approach.
5. Compare your answer to question 1 to your approach in question 4. Any differences? If so, could you still follow what you said in question 4?

## Case 17

### Commitments to Sustainability in the Oil and Gas Industry: Do the Actions Match the Words?

Sustainable development, a concept and movement founded at the Rio de Janeiro Earth Summit in 1992, has as its core agenda the harnessing of resources of the private sector in pursuing environmental and social imperatives without compromising—and ideally enhancing—profitability and value creation. The three components of sustainable development, environmental protection, social equity, and economic prosperity, form the basis for a reporting paradigm called the triple bottom line (TBL). The TBL approach is intended to help companies integrate the three components of sustainable development into their core operations and to translate sustainability theory into management practice. The focus of sustainable development and the triple bottom line is “entirely compatible with the goal of business itself; namely, the creation of long-term shareholder value. In fact, proponents contend, the TBL approach is merely an extension of the scope and time line over which a shareholder’s interests are assessed. The underlying rationale is that companies emphasizing the economic, social, and environmental dimensions of their business will be in a much better position to build competitive advantage, generate long-term wealth creation, and sustain profitability than companies that do not.”

According to the *KPMG International Survey of Corporate Responsibility Reporting*, which is conducted every three years and most recently in 2005, companies in the oil and gas industry “are paying ‘much more attention’ to corporate responsibility (CR) activities.... The 2005 survey reveals that 52% of oil and gas firms participating in the study “provide separate reports on CR activities, whether it is an environmental report or a full-blown sustainability

report, covering social, ethical, environmental and economic issues. That compares with under 40% [the] last time KPMG undertook the research in 2002.” Moreover, the type of CR reporting has shifted dramatically from purely environmental reporting before 1999 to environmental, social, and economic reporting in the ensuing years.

Iain McGhee of CorporateRegister.com, based in London, echoes this observation. McGhee notes that “the reporting history in the oil and gas industry has been characterized by a rapid evolution from single issue reporting, such as environmental issues only, to comprehensive multiple-issue reports covering social, environmental, and ethical issues in one document.” According to CorporateRegister.com Ltd., 99 oil and gas firms reported on corporate social responsibility and/or sustainability in 2006 compared with 26 in 1996, making oil and gas the third most prolific reporting industry.

Reporting on environmental issues includes, but is not limited to, the extraction, transportation, and processing of petroleum; resource conservation; ground, water, and air pollution; and biodiversity. Among the various social issues considered in oil and gas companies’ TBL reporting are local economic development, working conditions, diversity, human rights, safety, and social philanthropy. Economic issues include accountability and transparency, corporate governance, financial performance, and shareholder value, among others.

The sustainability agenda is so compelling for the oil and gas industry because of its own programs of global transition from onshore to offshore drilling, from shallow water to deep water drilling, from exploration and extraction in the industrialized world

to the developing world, from oil to gas stocks, and ultimately from fossil fuels to renewable fuels. "It seems clear then, that what sustainability in the oil and gas sector really implies is sustainability in the supply of energy, not the supply of oil and gas. In view of the complexity of these social, environmental, and economic challenges, it is perhaps not surprising that companies differ substantially in their stated understanding of sustainable development, their level of participation in the sustainability debate, and the extent to which they have been prepared to take action."

A study commissioned by the trade magazine *Fast Company* provides an interesting perspective on the variability

of sustainability reporting and actions within the oil and gas industry. *Fast Company* engaged the sustainability experts at HIP Investor Inc. and the Social Venture Technology Group "to analyze the world's 10 largest integrated oil companies by revenue (excluding majority state-owned operations)." HIP Investor and the Social Venture Technology "rate companies based on their management practices (including setting sustainability goals, and if and how managers are held accountable for those goals), as well as their human impact (such as human rights, greenhouse-gas emissions, and investment in renewable-energy sources)." The accompanying chart summarizes the key results reported by *Fast Company*.

Company	Headquarters Location	Management Practices Score (Out of 25 Points)	Human Impact Score (Out of 100 Points)	Sustainability Highlights
BP	London, England	14	54	Big investor in solar and renewable fuels
Royal Dutch Shell	The Hague, The Netherlands	15	47	Prepared for carbon pricing; already trading it
Chevron	San Ramon, California, USA	15	47	Tapping geothermal energy; but still in Myanmar
Marathon Oil	Houston, Texas, USA	11	42	Expanding ethanol capacity
ConocoPhillips	Houston, Texas, USA	11	40	Member of U.S. Climate Action Partnership
Total SA	Paris, France	11	40	Sells alternative fuels at pumps in France
Exxon Mobil	Irving, Texas, USA	10	39	Most emissions exposure by both size and rate
Repsol YPF	Madrid, Spain	11	34	Improved reporting, but little staff diversity
ENI	Rome, Italy	9	35	Impressive health care for workers
Valero Energy	San Antonio, Texas, USA	6	13	Secretive, but leader in refinery safety

Company headquarters data from Reuters Web site (search results/news) at <http://search.us.reuters.com>. Accessed April 22, 2008. All other tabular data based on Feldman (2008).

As is evident from the management practices scores and human impact scores, there is considerable variation across the 10 companies with respect to their commitments to sustainability. For instance, “Marathon has taken real steps to cut emissions of carbon, methane, and other pollutants. Last year, the company released 49 tons of greenhouse gases per 1,000 barrels of oil produced. In contrast, ExxonMobil produced 104 tons of greenhouse gases per 1,000 barrels.” However, Amy Feldman, a reporter for *Fast Company*, comments, “there is also plenty of window dressing that can obscure the overall impact of these businesses. Shell was recently forced to pull ads touting its green efforts by British regulators who found it had exaggerated. BP has paid massive fines for health and safety violations.”

Janet Guyon, writing in *Fortune* magazine about sustainability ratings provided by the Zurich, Switzerland-based firm Sustainable Asset Management and New York-based Innovest, observes, “Behind the high ratings from SAM and Innovest is the belief that better social performance indicates more-responsible leadership.” Martin Whittaker, writing in the *Oil & Gas Journal*, indicates that top-level buy-in may be the most critical factor in reorienting a company around TBL. In addition, becoming committed to sustainability requires a supportive organizational culture. Martin Whittaker also asserts that “the very uncertainty of oil and gas exploration itself has created a culture that is carefully comfortable with the management of change. Compared with other industries, most oil executives view risk and uncertainty with a cool eye. Companies have been forced to innovate, they say, both technically by the hostile environments in which they operate, and strategically by the geopolitical importance of oil and the hegemony of the Organization of Petroleum Exporting Countries. It remains to be seen whether this culture is deep enough to make what seems to be the biggest transition of all—to that of the sustainable energy company.

## Questions for Discussion

1. Do you believe the argument that companies operating according to the economic, social, and environmental components of the triple bottom line will be in a much better position to build competitive advantage, generate long-term wealth creation, and sustain profitability than companies that do not? Explain your answer.
2. Why have companies in the oil and gas industry embraced the sustainability concept? What does this suggest about leadership within these companies? What might it reveal about the culture of these companies?
3. Based on the information provided in the chart, what insights do you gain about oil and gas companies' commitments to sustainability?
4. What does the information provided in the chart suggest about each company's leadership and culture with respect to embracing sustainability?

## Sources

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## Case 18

### What's Written versus Reality: Ethical Dilemmas in a Hi-Tech Public Relations Firm

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#### Industry and Company Overview

The goal of public relations (PR) is to make desired targets aware of clients and products. Through relationships with the media—press, television, and Internet—as well as stock market analysts, client and product awareness are broadened. Articles in trade magazines and newspapers, television interviews, tradeshow bookings, promotional tours, and general market research on clients and their competitors are the stock and trade of this business. Consultative strategies on the launch of initial public offerings (IPOs), timing and marketplace, corporate branding, and crisis management, as well as C-level (CEO, CFO, CAO, CIO) media training sessions, are some higher-level offerings of PR agencies.

The nature of the PR industry is competitive, individualistic, and “catty.” Agencies compete for clients and qualified staff and are quick to bad-mouth their competitors. Very little loyalty seems to exist in this industry. Staff members are quick to “agency hop”—leave for a competing agency offering them more money—and to “client hop”—leave the agency to work for a client. Title inflation and pay inflation flourish in this individualistic and egotistical culture. As mediocre staff hop up the corporate ladder, title and pay grow commensurately. Eventually, it is discovered that these people are overpaid and underqualified; then they are blackballed. Word spreads rapidly throughout the industry regarding these peoples’ shortcomings, making it very difficult for them to progress further in their careers.

Additionally, agencies are eager to “client swap” or terminate their relationship with an existing client if a competitor offers the agency more money. The client with the biggest

budget wins, regardless of contractual obligations.

The nature of the PR professional is not reported favorably. An article in *PRWeek*, a major PR trade publication, reported that 25% of all PR professionals admit lying in order to advance their careers or their client’s business.

During the spring and summer of 2004 an ethical problem was unfolding in the Los Angeles office of the PR firm Fleishman-Hillard regarding false billing for services provided to the city of Los Angeles. The city canceled all contracts with PR agencies as a result of the false billing, implicitly calling into question the ethics of the entire industry. As Julia Hood, editor of *PRWeek* wrote in an editorial, “Is there any other industry where a unilateral ban on all service providers in a certain category would be enacted because of the actions of one firm?”

Concern about the use of video news releases and paid endorsements as PR tools also contributed to the negative perceptual indictment of the entire PR industry. Although both major industry groups—the Council of PR Firms and the Public Relations Society of America—have a general code of ethics, some PR professionals apparently violate the codes with some degree of frequency. Some PR professionals have criticized the Council of PR Firms and the industry asserting that “[a]s an industry, we need to be incredibly transparent.”

#### Seven Common Ethical Dilemmas

This case focuses on seven common ethical dilemmas that PR professionals have faced in a real public relations agency. Public Relations, Inc. (PRI) is a disguised name for an actual, medium-to-large agency located in the northeastern United States that specializes in PR consulting for hi-tech companies.

The seven recurring ethical dilemmas involve the following:

- Client noncompete agreements
- Client confidentiality with respect to insider information
- Integrity of client information
- Employee poaching
- Friends and family stock gifting
- Unrealistic financial forecasting
- Promised versus realized employee benefits

Several vice presidents and senior vice presidents at PRI were consulted to identify and validate these dilemmas and to discuss real-life outcomes when their own professional ethics are challenged.

**Ethical Dilemmas: Up Close and Personal** Each of the ethical dilemmas that have occurred (and still occur) at PRI is identified with an example. First, the written “policy” regarding the practice is identified. Then, an example of the dilemma is given, followed by the result. Finally, comments and afterthoughts regarding the dilemma are offered.

**Dilemma 1: Client Noncompete Agreements** Contracts between the agency and a client specifically state that the agency will not solicit or accept work from a competitor during the term of the contract. If the agency wants to pursue a competitor, it should end the relationship prior to making contact with the competitor. Of course, this is a gamble, so PR agencies rarely follow this clause if the competitor has more money to spend.

What’s Written

- The noncompete clause in the contract: “PRI will not solicit or accept work from a competitor during the term of this contract.”

Dilemma

- You have a long-standing relationship with Client G.
- This client is very demanding, and the staff members on the account are unhappy.

- One of your staff members has told you that he has a contact inside Client M, a more desirable client, but a competitor of Client G.

Reality: What Happened

- PRI contacted Client M, made the sales pitch, and won a contract. Upon Client M’s contract signature, PRI notified Client G that the relationship would be terminated.

Comments and Afterthoughts

This is commonplace in the PR industry. The client with the biggest budget wins; there is little, if any, client loyalty. In turn, there is very little agency loyalty. A company may burn through three agencies in one year. There is a disincentive, or “hassle factor,” as well as a cost factor in switching agencies. Bringing an agency “up to speed” on a company’s business and strategy can be time consuming.

**Dilemma 2: Confidentiality of Insider Information** Highly confidential client information is shared with PR agencies in an effort to place clients and their products in the best strategic position. Once the client–agency relationship is terminated, all documents containing confidential information are returned to the client. However, the staff cannot simply erase the information they absorbed while working for that client. Because PR professionals gain domain expertise by working with clients within the same industry, they are frequently asked to pitch to competitors of their current clients. Then, if the pitch is won, their current client is terminated, and the PR pro is assigned to the new competing client. Below is an example of a dilemma that occurred with the “Ford” and “Chevy” of hi-tech clients.

What’s Written

- The clause in the contract: “PRI will keep confidential all client information for the term of this contract.”

Dilemma

- Because you have industry-specific experience (you worked with Client G),

you have been placed in charge of the Client M account.

- You know that Client G is developing a new product that could clobber Client M's product.

#### Reality: What Happened

- Client M was not told the confidential information.
- Due to the financial impact of the competition, Client M reduced its marketing budget.

#### Comments and Afterthoughts

We are not aware of any breach of confidentiality at PRI. However, that does not mean that it does not occur. The guideline for this decision is whether the client is so unscrupulous that it would appreciate this kind of information. Sharing this kind of information is a double-edged sword; the client may be concerned that the PR firm would share its trade secrets and pull the business. Therefore, the motivation for keeping information confidential is often not an ethical decision, but a financial decision.

**Dilemma 3: Integrity of Client Information** PR professionals rely on client-supplied information. The information is then passed on to the media for broadcast or publication. It is not the responsibility of the PR agency to research the accuracy of client-supplied information. However, the blame can fall on the agency when things go wrong. What follows reflects information in a July 25, 2000, PRWeek article describing a PR agency that was blamed for publishing misinformation.

Pitching a CEO's credentials in a rags-to-riches tale is a tried-and-true PR tactic. But what if a client's head honcho lied on his resume, approved a press-kit bio constructed around these falsehoods, then turned around and pinned the blame on the PR firm when the media uncovered the truth? That's exactly what happened to The Horn Group, which found itself in Bay Area

headlines last week when the CEO of client Luna Information Systems tried to finger them for circulating "An Entrepreneur's Story"—press materials containing exaggerated and unfounded claims about his background and education.

The CEO told the Horn Group that he was a graduate of Harvard Business School and played professional soccer for eight years. All this was false. Still, how can a PR pro question a client on the truth or accuracy of information without offending the client in this egotistical industry?

#### What's Written

- As a PR professional, one is not required to check the accuracy of the information provided by the client.

#### Dilemma

- Client L is releasing a new product: Printer 2005.
- Your client has provided you with some product specifications that sound fabulous, almost "too good to be true."
- You have already lined up some great press opportunities and will lose them if you delay the release.

#### Reality: What Happened

- PRI questioned the information and gave up some of the press opportunities.
- The client was extremely offended and threatened to fire PRI.
- Client L's information was published and was wrong.

#### Comments and Afterthoughts

There is a balance among losing press arrangements, offending clients, and covering the agency's reputation. This is a judgment call.

**Dilemma 4: Employee Poaching** Contracts between the agency and the client specifically state the client will not solicit any employees of the agency

during the term of their contract. Knowing that this statement alone will not deter solicitation, the agency includes additional language: “If the client solicits and hires any employees from PRI, the client must pay 50% of the employees’ current salary.” Since headhunters charge fees up to 35%, the 50% charge acts as a disincentive. However, in a booming economy clients are willing to spend more to get the right person for the job. Paying the 50% fee for a known quantity is more efficient than paying 35% for an uncertain hire. Employees of the agency develop strong relationships with their clients as part of their jobs. If a client offers them a higher paying, more prestigious job, it is tough to pass up the opportunity.

#### What’s Written

- Included in the client contract is this clause: “If Client L solicits and hires any employees from PRI, Client L must pay 50% of employees’ current salary.”

#### Dilemma

- You have a great relationship with your client, Client L, and have secretly contemplated working at Client L.
- Client L has mentioned that there is a position available that would be “perfect” for you . . . but that the 50% fee is a lot of money.

#### Reality: What Happened

- Together, the employee and Client L approached PRI’s CEO.
- The 50% fee was waived in exchange for increased business for PRI.

#### Comments and Afterthoughts

This is a win–win situation—and is rare. There are three clients that currently owe PRI fees for employee recruitment. Since the client relationships have been terminated, PRI has little leverage for collection. Legal suits have been filed in these three cases.

#### **Dilemma 5: Friends and Family Stock Gifting**

The clients of PRI are dot-coms and hi-tech companies requiring assistance in their IPO launches and with general PR. Clients commonly offer friends and family (F&F) stock to the agency and its employees. To avoid conflicts of interest, PRI has a “Just Say No” policy to such stock offers. This policy is more to protect the firm from legal liability of conflicts than to act ethically. Clients not offering F&F stock may try to claim that they were not given the same level of service, interview opportunities, press coverage, and so on as clients that contributed stock.

#### What’s Written

- PRI has a “Just Say No” policy to F&F stock.

#### Dilemma

- You have a long-standing relationship with Client I.
- This client is launching its IPO next month, which is expected to be very successful.
- Knowing your policy, Client I offers F&F stock for your spouse.

#### Reality: What Happened

- No stock was accepted.

#### Comments and Afterthoughts

We are only aware of this case because the employee informed PRI. There may be many cases of which PRI is unaware.

#### **Dilemma 6: Unrealistic Financial Forecasting**

The senior management team is recognized and rewarded for business growth, organic growth of existing clients’ accounts, and new clients. In order to appear successful, many of the senior managers are overly conservative—that is, they “sandbag” or low ball their forecasts of clients’ planned spending with the agency. Then when actual revenues are higher than originally planned, the senior manager looks like a hero and is awarded a bonus accordingly.



### What's Written

- Forecasts should be accurate for the good of the company.

### Dilemma

- Your bonus is based on increased activity from the annual forecast of the organic growth of existing clients (as well as new business).
- All your clients have increased their budgets for next year.
- If you claim this in the annual forecast, you will need to grow the business even more over the year to realize your bonus.

### Reality: What Happened

- Sandbagging!
- Results: A scramble to hire more staff, inappropriate expense planning, and overall inaccurate information for decision making.

### Comments and Afterthoughts

The reward system needs to be changed to encourage behavior that is desired—namely, accurate forecasting.

***Dilemma 7: Promised Versus Realized Employee Benefits*** This is a dilemma of cultural conflict. As in many companies, PRI has a “face-time” culture. The senior leaders paid their dues by working long hours and, consequently, expect their junior staff members to do the same. Although PRI presents itself as a results-oriented agency, the “face-time” culture dominates. Additionally, there are political battles among some of the senior leaders. This conflict filters down to middle management and below. How can a middle manager fairly lead his or her staff without limiting his or her own advancement?

### What's Written

- PRI offers a new flextime condensed workweek available to all employees, with manager approval (created by Human Resources).

### Dilemma

- Your boss does not support this plan and has an adversarial relationship with the head of Human Resources.
- A staff member has requested a condensed workweek.
- You know that approving this request may be a career-limiting move for both you and the staff person in this “face-time” culture.

### Reality: What Happened

- The manager encouraged the staff person to wait 90 days and see how other staff members manage their workload on this plan.
- The manager suggested to the boss that the staff person participate in the flextime plan as a show of support for the CEO (self-promotion).
- The boss said, “NO!”

### Comments and Afterthoughts

Employee participation in this flextime program is less than 5%. The corporate culture is contradictory to a traditional 40-hour week, much less a flexible 40-hour week. The regular week is 50 plus hours of face time.

### PRI's Ethical Profile

***Leadership*** The managers at PRI seem to relate to their constituencies from an amoral orientation—although willful wrongdoing probably does not exist, little, if any consideration is given to the moral implications of decisions and actions. PRI managers often act without consideration of or concern for the consequences of their actions for other stakeholders; instead, they operate on the basis of the “ends justifies the means.” The egotistical nature of the organizational culture feeds into this style of leadership. Motivations that drive managers’ actions include power, ego, and economics. The leadership has a short-term focus and lacks trust or long-term relationship-building qualities.

**Culture** The culture in this industry and at PRI is individualistic and ego-tistical. The industry is also very competitive. There is little loyalty, either between agencies and clients or between employees and their agencies. This culture does not encourage professionals to act in an ethical manner. As was mentioned earlier, 25% of all PR professionals admit to lying.

**Structure** PRI has several locations throughout the world and is one branch of a larger network of PR firms worldwide. Consequently, the company has a divisional structure that operates in a fairly decentralized manner. Due to the looser control associated with decentralized structures, additional opportunities for engaging in unethical behavior can arise.

**Control Systems** The contracts that exist between agencies and clients compose one system that is put in place to govern the behavior of the two parties. The contracts are typically prepared by the PR agency. Some clauses can be very specific and detailed when it is in the best interests of the agency, such as the employee poaching clause. In other cases, when there is not such a specific benefit to the agency, wording in the contract is often vague, as in the client confidentiality clause. In this example, nothing is said to indicate that the information should be kept confidential when the contract expires or is terminated. This, and other similarly vague clauses, leaves employees to face ethical dilemmas regarding appropriate behavior.

Although there are contracts governing the relationship between the agency and the client, there are no clear written policies for the employees. A clear set of guidelines could help employees understand the agency's expectations regarding appropriate decisions when faced with common ethical dilemmas.

As the unrealistic financial forecasting dilemma described, there is a reward system in place for agency

employees. Company reward systems can have a profound influence on employee behavior. Companies should evaluate their reward systems carefully to ensure that they reinforce desired behaviors. In this case, the structure of the reward system has negative consequences in that it encourages managers to make overly conservative forecasts. The result is the inability of the firm to gather accurate information for planning and decision making.

**Impact of These Factors on Employee Behavior** The relationship among these factors at PRI influences the actions of employees. The decentralized structure and lack of clear policies encourage a climate that allows immoral activities, especially when there is strong pressure to increase profits. An incentive system driven by numbers encourages shortcuts around responsible decisions. The amoral orientation of the culture and leadership may inadvertently condone questionable, if not immoral, decisions and actions. Of course, PRI is not alone in facing these problems.

**Closing Thoughts** PRI's leadership may not be able to overcome industry and company barriers to create a truly high-ethics environment. The owners and top managers do not appear to want their employees to act with any absolute sense of what is right and wrong. They do want employees to use a "reasonable person" approach to decision making when faced with ethical dilemmas. PRI's leaders would, in all likelihood, encourage entrepreneurial and competitive interpretations regarding what the "right decision" would be in a particular situation.

PRI can take certain actions to help employees resolve ethical dilemmas. A set of guidelines could be developed to help people do "the right things" in very gray areas—especially in addressing common ethical dilemmas faced in this industry. Top managers could lead by example and ensure that their behaviors are consistent with the behaviors

they desire from employees. The reward system could be reevaluated to ensure that it rewards the desired results without creating other dilemmas for the agency. In summary, the agency should try to implement some measures that achieve the desired results—results that do not always clash with the highly competitive industry culture.

### Questions for Discussion

1. How would you conduct yourself regarding each of the seven dilemmas if you were a PRI employee? Explain.
2. How would you “fit” at PRI as an employee? Do your “ethics” match the company’s ethics? Explain.
3. What issues would you likely face as a leader (either CEO, CFO, or CIO) at PRI? Explain.
4. Do PRI’s leaders face the same ethical tensions and consequences as its lower-level employees? Explain.
5. As an ethics consultant, what specifically, if anything, would you recommend to the PRI leadership regarding the ethical dilemmas it continually faces? Explain.

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# 7

## EMPLOYEE STAKEHOLDERS AND THE CORPORATION

### 7.1 Employee Stakeholders in the Changing Workforce

Ethical Insight 7.1

### 7.2 The Changing Social Contract between Corporations and Employees

### 7.3 Employee and Employer Rights and Responsibilities

Ethical Insight 7.2

### 7.4 Discrimination, Equal Employment Opportunity, and Affirmative Action

Ethical Insight 7.3

### 7.5 Sexual Harassment in the Workplace

### 7.6 Whistle-Blowing versus Organizational Loyalty

#### Chapter Summary

#### End-of-Chapter Questions and Exercises

#### Real-Time Ethical Dilemma

#### Cases

Wal-Mart: Ongoing Changes with Gender Discrimination

Don't Ask, Don't Tell: A Policy on Gays in the Military

Women on Wall Street: Fighting for Equality in a Male-Dominated Industry

## OPENING PROFILE

### Two Profiles

#### Profile of the New (Younger) Workforce

"Stand back all bosses! A new breed of American worker is about to attack everything you hold sacred: from giving orders, to your starched white shirt and tie. They are called, among other things, 'Millennials.' There are about 80 million of them, born between 1980 and 1995 [others say between 1982 and 2003], and they're rapidly taking over from the Baby Boomers who are now

pushing 60."<sup>1</sup> "We are beginning to see increasingly younger people come in and ask long term questions; five years down the road, where can I grow in this company? This was not necessarily the case with Gen X [people born between 1964 and 1981]. There is also a greater emphasis on bonding within an institution. Some companies are actually having camps and retreats where they immerse people into living with one another 24/7 (like Accenture), learning the lore of the company. This would not have gone well with Gen X. This would have caused a riot with the Boomers, and Gen X simply wouldn't have been interested.... Employers

hate the parental presence, but it is now extending into the workforce.... Excessive parental involvement was originally the single biggest complaint among teachers several years ago, then it predictably moved into colleges, and now it is becoming a pervasive issue in HR [human resource] departments with parents doing everything from helping fill out applications to actually coming to their children's interviews.... Many employers are working with this trend ... employers are now working on co-marketing to parents."<sup>2</sup>

### Second Profile of the New (Older) Workforce

"Shirley Serey is the community college student of the future: 59 years old, MBA, corporate manager, breast cancer survivor—and new teacher of special education, helping fourth and fifth graders with disabilities learn to read.... Serey is at the leading edge of tens of millions of Baby Boomers who are beginning to shift into a new phase of life and work. As many as four out of five people in their 50s and 60s say they expect to continue to work, some because they have to for financial reasons, but many more because they want to, for the social connections, intellectual engagement, and fulfillment of making a difference. Neither old nor young, many are seeking 'encore careers' that combine a renewed commitment with continued income and increased flexibility.... Shirley Serey is typical of the target market for such encore colleges. Her story weaves several themes common to boomers managing transitions to this new stage of life—the need for flexibility, the unexpected obstacles in the search for meaning, an impulse to give something back, to help other people, and to make a direct and noticeable impact."<sup>3</sup>

Employers and employees are experiencing a different mix of values, styles, and dilemmas in the changing workplace, as the opening scenarios indicate. A review of workforce trends also indicates significant changes at the societal level, e.g., "the Department of Labor must work with a wide spectrum of job seekers, including those with special needs such as the disadvantaged,

people with disabilities, veterans, disadvantaged youth, and those who have lost their jobs due to foreign competition. Addressing the job seekers' needs is further complicated by the dynamics of the changing workplace. New technologies, increased competition, and changing labor markets have prompted employers to downsize, change employment patterns, and seek alternative labor sources such as qualified foreign workers."<sup>4</sup> In addition, "evidence from an extensive national survey ... showed 70% of ... employees are waiting for the economy to improve so that they can leave their current situation.... Also, more than 25% of the working population will reach retirement age by 2010, resulting in a potential shortage of nearly 10,000,000 workers. One-fifth of this country's large, established companies will be losing 40% or more of their top-level talent in the next five years ... the 24 million people who stop working in this decade will be experienced employees who are headed into retirement."<sup>5</sup>

This chapter addresses the questions: What is different about the workforce, and how does this affect the corporation's ethical responsibilities? What, if anything, binds employees to their companies these days? What is the changing nature of the employer–employee social and psychological contract? How has this contract changed historically? What are the boundaries of employee loyalty? When do employees have the right or obligation to "blow the whistle" on a company?

A number of issues that employees and employers face are also presented, such as dating in the workplace, same-sex marriage rights, types of discrimination, drug testing, Internet use, privacy, and sexual harassment. The rights and responsibilities of both employers and employees are discussed with the aim of offering perspectives on what stakeholders can expect and how ethical dilemmas can be prevented and solved beginning with an awareness of these

issues. Creating a legal and ethical working environment where mutual respect and concern create conditions for productivity and human development is a worthy goal.

### Questions for Discussion

1. Which employee profile do you identify with most? Explain.
2. Whom would you prefer to manage most, the first or the second profile? Explain.
3. Which employees do you believe might present more issues in the workplace, profile one or two?

## 7.1 EMPLOYEE STAKEHOLDERS IN THE CHANGING WORKFORCE

The forces of globalization, deregulation, shareholder activism, and information technology continue to influence business practices and processes, as discussed in the previous chapters. Industries and companies are downsizing, restructuring, merging, and reinventing their businesses. Mid-level management layers are being pressured, many even diminishing. Functions are being outsourced, offshored, eliminated, and replaced by online automation, cheaper international labor, and networked infrastructures. Knowledge workers with technological and people skills must manage processes and themselves in cyberspace with speed, efficiency, and accuracy.

Within the context of the “digital economy,” the following changes with employees and professional stakeholders continue to occur:<sup>6</sup>

- An increasing shift to knowledge work, which increases the potential for satisfying work but heightens stress.
- The concept of “a job and career for life” is dead or dying. An employee holds nine jobs by the age of thirty. Professionals are changing careers five to eight times on average during their working lives. Compensation, income, and the social distribution of benefits, including health care, are pressured by changing national and global economic conditions. Decreases in income are occurring among middle- and low-level professionals, and the gap between upper- and mid-to-low-level income holders is widening.
- Quality of work life is not inherent or guaranteed in the workplace. In one worst-case scenario, Thomas Malone of MIT stated that all work relationships could possibly be mediated by the market, with every employee functioning as a company in shifting alliances and ventures.<sup>7</sup>

Change in the workforce and workplace presents ethical tensions and issues that are addressed in this chapter.

### The Aging Workforce

Between 2004 and 2020, the number of workers age 55 and over will increase by 80% to over 33 million.<sup>8</sup> In 2001, for the first time, the number of workers aged 40 and older surpassed the number of those younger than

forty. At the same time, those aged 16 to 24—the “Baby Busters” (who were born after the Boomers)—made up 16% of the workforce, a proportion that continues to decrease. The seniors, older than age 55, represented about 13% of the workforce. Japan was the first nation ever with a population in which the average age is forty. By 2020, 6 out of 10 Japanese workers will be retired. Combined with generational differences, age differences can aggravate values and work ethic clashes as the Real-Time Dilemma case exemplifies. Does age play a role in the “Real-Time Dilemma: What’s Going on Here?” shown in this section?

One result of the population growth slowdown is that the number of managerial leadership positions will outstrip available talent. As Baby Boomers age and retire, the number of managerial positions required is predicted to increase by 20% from 2000 to 2010, while U.S. demographic projections indicate a drop of 15% in the number of workers aged 35 to 44 (the pool from which these positions are filled) during this period. Older workers will be needed for their skills and experience, and also because of the shortage of younger workers to replace them.<sup>9</sup>

## Generational Differences in the Workplace

As the opening profile suggests, generational differences offer challenges to coworkers and managers. Generational analysis looks at differences among world views, attitudes, and values of generations of Americans. Large differences in the generations from World War II to the present in the U.S. population have had a substantial influence on government, corporate, and workplace policies. This information, although subjective, is used to develop workplace strategies and to evaluate ethical principles and beliefs of different groups in the workforce.<sup>10</sup> The following brief summary of five generations’ dominant value orientations highlights some of these differences. As you read the descriptions of generational profiles, turn again to the “Real-Time Dilemma: What’s Going on Here?” to help explain possible sources of the conflict and potential organizational issues and dilemma that are about to erupt.

- **GI Generation (born 1901–1925)** This generation survived the Great Depression and served in World War II. Members of this generation are churchgoers and belong to clubs and professional organizations. They express rugged individualism but are members of many groups. They tend to believe in upward mobility, civic virtue, and the American Dream.
- **Silent Generation (born 1926–1945)** This generation was too young to fight in World War II. They were influenced by the patriotism and self-sacrifice of the GI generation, from whom they did not wish to differentiate themselves. Their dominant principles are allegiance to law and order, patriotism, and faith. The Silent Generation likes memorabilia such as plaques, trophies, and pictures of themselves with important people.<sup>11</sup>
- **Baby Boomers (born 1945–1964)** This is currently the most powerful demographic generation, with 76 million members. They have led and set trends in society. They distinguish themselves from the former generations by assuming debt. Their “buy now, pay later” belief characterizes their instant gratification practices. They can be moralistic, but they question

authority and the moral and ethical principles of institutions. They do not “join” or sacrifice personal pleasure for the good of the group or collective. They mix and match religious traditions and avoid the dogma and teachings of single religions. Baby boomers value health and wellness, personal growth, involvement, public recognition, status symbols, first-class travel upgrades, visible roles such as speaking at an industry trade show, and any type of resort or retreat.<sup>12</sup>

- **Generation X (born 1965–1981)** Known as the “baby busters,” this generation has 41 million members. Sandwiched between the two larger generations, they feel demographically overlooked. They came from a time of high national debt and bleak job markets, and were labeled as the “McJob” generation—a phrase referring to holders of low-level, entry-level jobs. This generation generally believes that they will get less materially than the boomers. Insecurity is a dominant theme for X-ers, who value close friends and virtual families more than material success. They, like the boomers, are also suspicious of institutions. They experience their journey through life as one that changes rapidly and continuously.
- **Generation Y (born 1982–2003)** The millennial generation (or “echo boomers”) numbers about 80 million. They spend \$170 billion a year of their parents’ and their own money and comprise one-third of the U.S. population. They have grown up with television, computers, instant messaging, and new technologies, just as the boomers grew up with the telephone. Y-ers don’t want to be associated with X-ers, whom they believe are selfish and complaining and the least heroic generation—a bunch of “slackers.” Y-ers started growing up with a strong job market. They are ambitious, motivated, extremely impatient and demanding, and have a sense of entitlement.
- **Millennials (Generation Y)** This group is also extremely practical. They welcome clear rules and guidelines, and display high levels of trust and optimism. They are keenly aware of current events and are sensitive to their surroundings. They define success in terms of team rather than individual achievement.<sup>13</sup> Generation Y is more positive than other employee groups and is more likely to agree that “senior management communicates a clear vision of the future direction of my organization.” They:
  - have more favorable views on workplace issues, from work-life balance to performance reviews to having access to their immediate supervisor.
  - value teamwork and fairness and are more critical than other age groups on issues of fairness and cooperation.
  - want to be challenged at work.
  - are motivated less by money and more by opportunities to advance and have a life outside of the office.
  - are concerned about tuition reimbursement and flexible spending accounts for dependent care.

Over half of Generation Y-ers would leave their organization to work for an organization that offered better benefits.<sup>14</sup>

From a manager’s viewpoint, Generation Y employees require “super-high maintenance,” since they are “on fast-forward with self-esteem.” They

often expect office cultures to adapt to them. With these attitudes, they generally require coaching, rigorous feedback, and smaller and more realistic goal setting, with deadlines and increasing responsibility.

From the employer's perspective, integrating individual and group differences in the workforce requires, as mentioned earlier, leadership, planning, new policies, and training. In larger, more complex organizations, providing education and training to integrate the workforce is a necessity.<sup>15</sup> With which of these values do you identify? What other values that are not listed here motivate you? Underlying individual values combined with other background factors influence perceptions, beliefs, behaviors, and ethical decisions.

## Steps for Integrating a Multigenerational Workforce

Generational differences may be only one among several issues that cause conflict and ethical dilemmas in the workplace. Using communication skills and emotional intelligence (managing self, others, and relationships with awareness and sensitivity) are important. Here are steps that employers can use to help diagnose, prevent, and resolve misunderstood generational differences. If you are not a boss, team leader, or supervisor, read these steps as if you were one. Taking this perspective can help you see the larger picture outside of a particular generational lens.<sup>16</sup>

- **Identify the the problem areas.** Where do I see the problems? Where do I expect to see the problems? Is there resentment about special treatment to senior or younger members in the workplace? Are the problems between individuals or groups from different generations? What are the sources of the problems: value differences, rewards, motivation, work methods, other?
- **Get to know the individuals inside their roles and positions.** For Millennials and Gen Xers, as well as members of other generations, it is important to arrange for conversations to discuss broader topics and subjects that are important to them. Do not wait for employees to come to you, it is important to plan, arrange, and invite individuals to conversations where needs and perceptions can be shared in non-threatening ways. Being able to listen to the other's views, opinions, and perceived or experienced issues will help you understand the person and his or her issues. These are necessary first steps that lead to problem resolution.
- **Understand and anticipate expectations of different generations.** "One size (of leadership or management) does not fit all." While individuals must be recognized and treated as the unique individuals they are, it is also important for managers to seek balance between the employee and the company. Knowing generational members' expectations is important in negotiating this balance between responsibilities and obligations. "This can be achieved when a company (1) does not ask too much of its employees and (2) knows what it's willing to give employees *before* they've been given too much."<sup>17</sup>
- **Develop a personal growth and development plan for each employee.** Millennials and Gen X-ers value and enjoy learning and benefit from their

work when they are engaged. Assisting them to develop specific future goals and marketable skills is motivational and will focus their high work ethic and energy toward positive effort and outcomes.

- **Engage and communicate.** Younger entrants into the workforce are accustomed to being engaged, not mandated or reprimanded in an authoritarian way. Seek their input and advice. Conflicts between Gen X-ers and Millennials often occur when the former try to take charge over the latter. Neither likes to be told unilaterally what to do. If reprimands or criticisms are necessary, these can best be communicated one-on-one, as soon as a wrong action is done, and as objectively as possible. Reverse mentoring and mutual mentoring are two newer ways that Gen X-ers and previous generational types can learn from younger professionals. These more recent forms of mentoring can be effective ways of sharing and learning different professional values and work ethics.
- **Be a leader, not a friend.** Gen X-ers and new Millennials are looking for role models in organizations, not buddies in a boss. Both generational members want to be led, since they generally have friends. This does not mean that they want to be led by authoritarian or unreasonable leaders. Character counts. Gen X-ers and Millennials move toward bosses who have strong character. They know when they see strong character. For effective managers, character means, “Do what you say and say what you do” in a reliable, trustworthy way and “Do the right thing”—although it may not always be comfortable.

#### ETHICAL INSIGHT 7.1

### Bridging Diversity Gaps in the Workplace

#### Do Companies Use Mentoring Programs and are the Programs Effective?

- 71% of Fortune 500 companies operate a mentoring program (Bridgeford, L. [August 1, 2007]. Mentoring programs still have a place in the 21st century. Employee Benefit News.)
- 69% of surveyed companies across industries run formal mentoring programs; 74% of those programs are dedicate to women (Catalyst, 2006)
- 60% of British business leaders worked with a mentor; 97%

related that they gained from the advice given (DDI, 2005)

- 47% of surveyed organizations have mentoring programs (The Coaching/Mentoring Practitioner Consensus Survey. [2007]. The Institute for Corporate Productivity.)
- A meta-study of 151 studies on mentoring showed that 90% demonstrated positive outcomes (B.C. Hansford, L.C. Ehrich and L. Tennent, 2003).

#### New and Changing Types of Mentoring Programs

The old mentoring model assigned a younger professional to a more

*(continued)*



(Continued)

senior professional for an indefinite time. The following programs reflect new trends:

- **Short-term, goal-oriented mentoring:** Mentor/mentee are paired with specific goals that have time limits
- **Peer-to-peer mentoring:** Young employees are paired together
- **Speed mentoring:** Mentor/mentee are paired in restricted time-bound sessions for quick-hit information and networking, e.g., one hour
- **E-mentoring:** E-mail is the medium between paired mentee and mentor
- **Reverse mentoring:** Senior executives mentees are paired with younger professional mentors to help senior executives catch up on new practices (Kitchen, P. [November 2005]. Mentors' odyssey picks up a thoroughly modern pace. *CHANGING@WORK*.)
- **Job-fit-related mentoring:** Particular mentors and mentees are assigned

to work on specific jobs (Offsteing, E., Morwick, J., Shah, A. [2007]. Mentoring programs and jobs: A contingency approach. *Review of Business*.)

- **Mutual learning, adaptation, and change:** Mentor and mentee are paired based on a learning partnership aimed at mutual growth and development (Katz, N. [February 2007]. Enhancing effectiveness in mentoring. *Nation's Cities Weekly*.)

### Questions

1. Which of the above types of mentoring programs might help ease the potential ethical dilemmas in the "Real-Time Dilemma: What's Going on Here"?
2. Suggest how one or more of the mentoring programs here might be arranged by Ralph the CEO to help Bill and Lana's working relationship.

**SOURCE:** Mentoring: Current Trends. (November 16, 2007). <http://www.insala.com/Articles/leadership-coaching/mentoring-current-trends.asp>. © Insala All Rights Reserved 2008.

## Women in the Workforce

Women represented 46.5% of the U.S. workforce in 2002, with 50.5% in management and professional specialty positions. This figure is projected at 48% in 2008 and 10 million by 2010.<sup>18</sup> Two-thirds of the new entrants between 1985 and 2000 were women. Women with children less than six years old represent the most rapidly increasing segment of the workforce. Women hold over half of managerial and professional specialty positions. Of members of boards of directors, 12.5% are women; 4.1% of top earners are women. Two women were *Fortune* 500 CEOs in 2000. The Spencer Stuart in a 2006 report found that women represented 16% of boards of directors, with 3% of firms having no women directors. Women are also noticeably lacking on corporate boards in France, Spain, and the United Kingdom.<sup>19</sup> Figure 7.1 suggests questions leaders and managers can ask to assess whether or not their organizations are capitalizing on gender diversity.

Figure 7.1

### Does Your Organization Capitalize on Gender Strength?

- What evidence demonstrates that women enjoy working in the organization, and how is this monitored?
- What training and development opportunities are there, and how well are these accessed?
- What mentoring and coaching opportunities exist for women? How are these implemented and monitored?
- Do women have real choices about work-life responsibilities?
- How is women's advancement supported through internal networks?
- Who are the women's visible role models in the organization and why?
- How does the organization actively attract and position itself with women?
- What do the stats and trends show when it comes to attracting, retaining and developing women?
- How can women be assured of fair and transparent promotion processes, and accessible dispute mechanisms?
- How are equal pay for equal work, fair rewards, and recognition for women monitored?
- What do the women think about the effectiveness of parental and care support options?
- What external awards and recognitions have the organization (and the female employees) received?

**SOURCE:** Adapted from Aurora Gender Capital Management online service for women to research and compare organizations at [www.wherewomenwanttowork.com](http://www.wherewomenwanttowork.com).

Catalyst, a New York-based working women's organization, released a recent survey, "Women in U.S. Corporate Leadership: 2003," titled "What Keeps Women from Reaching the Top?"<sup>20</sup> The findings showed the top five barriers to be:

- Lack of significant general management or line experience (47%)
- Exclusion from informal networks (41%)
- Stereotyping and preconceptions of women's roles and abilities (33%)
- Failure of senior leadership to assume accountability for women's advancement (29%)
- Commitment to personal/family responsibilities (26%)<sup>21</sup>

In the same study participants cited the following top five success strategies they used to reach the top:

- Exceeding performance expectations (69%)
- Successfully managing others (49%)
- Developing a style with which male managers are comfortable (47%)
- Having recognized expertise in a specific content area (46%)
- Taking on difficult or highly visible assignments (40%)

Do you agree with the top five barriers women face to “get to the top” of organizations? If not, what factors do you believe account for the lack of advancement of women to more senior level and corporate board positions?

## Same-Sex Marriages, Civil Unions, Domestic Partnerships, and Workforce Rights

“Gay [same-sex] marriages are still not recognized under federal law, which defines marriage as a union between one man and one woman.” This means that health care benefits offered to a same-sex spouse by a partner’s employer are federally taxed. Also, no Social Security benefits can be passed on to surviving same-sex partners.<sup>22</sup> In 2004 Massachusetts became the first state to grant gays and lesbians the right to marry. Whether or not other states will recognize Massachusetts’ same-sex unions is unresolved. How would the benefits be affected, for example, of a same-sex married Boston employee moved by an employer to another state that prohibits gay marriages? “Civil union,” a new legal category, has been created that extend rights to same-sex couples. These rights are recognized only in states where these couples reside: Vermont (since 2000), Connecticut (since October 2005), New Jersey (since December 2006), and New Hampshire (since 2007). “Domestic partnership,” another new category, was created that gives rights to unmarried couples, “including (but not necessarily limited to) same-sex couples. Laws vary among states, cities, and counties. Terminology also varies; for example, Hawaii has “reciprocal beneficiaries law.” These rights are recognized only on the state or local level so designated, e.g., certain spousal rights of same-sex couples exist in California, Hawaii, Maine, Oregon, Washington, and the District of Columbia.<sup>23</sup>

Denmark, Norway, Sweden, Germany, and France have similar domestic partnership systems. The Netherlands expanded its definition of marriage in 2001 to include both opposite-sex and same-sex couples. Belgium followed in 2003, along with Ontario, a Canadian province in Canada. Same-sex marriage became available in three Canadian provinces (British Columbia, Ontario, and Quebec) and in one territory (Yukon) in 2004. Lawsuits are ongoing in Manitoba and Nova Scotia. If these courts approve same-sex marriage, over 80% of Canadian same-sex couples can marry in their own province.<sup>24</sup>

Some political jurisdictions have special legislation that allows gay and lesbian couples to register their committed relationships and gain some benefits. However, they do not receive all of the advantages that opposite-gender couples automatically acquire when they marry. These areas include most of the Scandinavian nations, the state of Vermont in the U.S. (where the arrangement is called a civil union), a few other U.S. states, and a few provinces in Canada.<sup>25</sup>

Nearly 6,000 U.S. employers have offered medical benefits to over 125,000 of their employees in same-sex unions. At least 198 members of *Fortune* 500 firms extend such coverage. A Hewitt Associates 2000 survey showed that 600 companies (or 22%) offered partner benefits. Companies are motivated to do so to help recruiting, retention, and corporate reputations. This coverage adds only 1 to 2% to a firm’s health care costs.<sup>26</sup>

## The Increasing Cultural Mix: Minorities Are Becoming the Majority

By 2050, the U.S. population is expected to increase from 282.1 million to 419.9 million. By that time, if not before, white people will be a minority in the U.S. “As of 2006, one in three people in this country was a person of color. ‘To put this into perspective, there are more minorities in this country today than there were people in the United States in 1910. In fact, the minority population in the U.S. is larger than the total population of all but 11 countries,’ Census Bureau Director Louis Kincannon said in a statement.”<sup>27</sup> Facts from the newest Census Bureau data, July 1, 2005 to July 1, 2006, show that “People of color now account for 100.7 million of the [U.S.] population, with Latinos as the largest group. A year ago, people of color totaled 98.3 million.”<sup>28</sup> The black population in the U.S. totaled more than 40 million, or 13.4 percent of the population. Latinos, the fastest-growing group, are the largest minority group, at 44.3 million, or 14.8 percent of the population. Asians are the second fastest-growing group, with a 3.2 percent increase. “Four states—California, Hawaii, New Mexico and Texas, as well as the District of Columbia—now have people of color as the majority. People of color on average are younger than white people. The median age for Latinos was 27.4, compared with 36.4 for the population as a whole. The median age for the black population was 30.1 and the median age for the Asian population was 33.5.”<sup>29</sup> The impact of these demographic changes on markets, customers, workforce composition, values and ethics will be significant.

## Educational Weaknesses and Gaps

U.S. students finished in the bottom half on math skills according to a new OECD (Organization for Economic Cooperation and Development) international comparison shown for 15-year-olds. Students in Hong Kong, Finland, and South Korea excelled in mathematics from the 40 surveyed countries. The U.S. also had the poorest outcomes per dollar spent on education, ranking 28 of 40 countries in math and 18 in reading. “The gap between the best and worst performing countries has widened,” said Andreas Schleicher, the official who directed the study and wrote the report.<sup>30</sup>

The survey also questioned students about their own views of themselves and their work, and it found that although good students were more likely to think they were good, countries that did well often had a large number of students who did not feel they were doing well. The study also reported that although girls typically did only a little worse than boys on the test, they consistently reported much lower interest in and enjoyment of mathematics and much higher levels of helplessness and stress in mathematics classes. The study concluded that “while spending on educational institutions is a necessary prerequisite for the provision of high-quality education, spending alone is not sufficient to achieve high levels of outcomes.”<sup>31</sup>

## Mainstreaming Disabled Workers

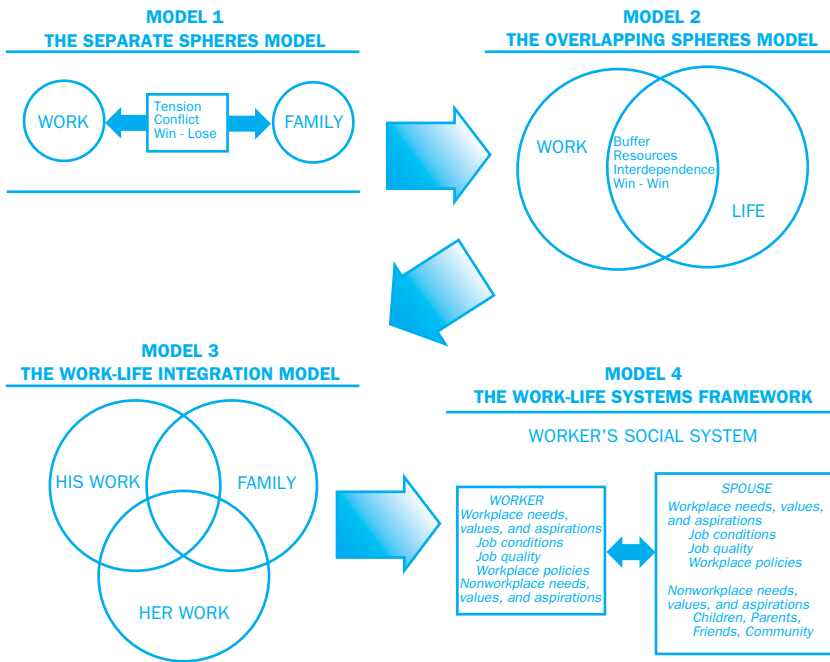
Hiring and mainstreaming qualified disabled workers is increasing in importance because of the combined effects of the shrinking and aging of the workforce. A survey by the International Center for the Disabled found that two thirds of the working-age disabled were not in the workforce, although a “large majority” said they preferred to work.<sup>32</sup> Disabilities affect a large percentage of the workforce. There are about 54 million individuals with disabilities nationally. Disabilities are categorized as permanent (for example, physical disabilities), temporary (such as those resulting from injury or stress), and progressive (e.g., AIDS, alcohol and drug addiction, cancer). A 2004 assessment from the National Organization on Disability/Harris Survey of Americans with Disabilities concluded that disabled Americans are three times as likely to live in poverty as the general public, twice as likely to drop out of high school, and twice as likely to be constrained by transportation options; also, three times as many individuals with disabilities have less health care than the general public. It is interesting to note that “everybody is just one car wreck away, a diagnosis away, a progressive condition away from joining the ranks of the disabled.”<sup>33</sup> Employers who hire persons with disabilities report they are more likely to be loyal, appreciative to their employers, and able to think outside the box.

## Balancing Work/Life in Families

A paradigm shift toward a new “work-life” model: As more dual-career and child-rearing couples enter the workforce, conflicts and problems evolve over roles and responsibilities as families cope with workplace demands. Working family models illustrating these tensions have evolved over decades. Four such models, which are summarized in Figure 7.2, include: (1) an early model depicting complete separation of work and family life and issues, in which men worked and women maintained the family; (2) an overlapping model of “work” and “family life” spheres in which the boundaries were still fuzzy, but roles were recognized as being interrelated; (3) a model that defined multiple roles and responsibilities, including “his work,” “her work,” and “family” obligations, which, like the previous two models, was based on scarcity and zero-sum assumptions (i.e., a fixed number of resources that resulted in win-lose situations) regarding the allocation and use of resources and responsibilities at home and at work; and (4) the most recent work-life systems model, which assumes a systems perspective in which roles and responsibilities are not seen as competitive, isolated, or overlapping in undefined ways between family members, and the organization and community are built into individual and family responsibilities, which are shared to optimize the well-being of the entire system (company, employees, and families). In the fourth model, the emphasis also shifts from individual and family to include workplace needs, values, and aspirations; job conditions; and quality of life. Company policies are recognized as part of the work-life equation and include flextime and part-time arrangements.

Figure 7.2

## Evolution of Work and Family Life Systems Models



**SOURCE:** Adapted with permission from Barnett, R. (Mar. 1999). A new work-life model for the twenty-first century. *Annals of the American Academy of Political and Social Science*, 562, 143–158.

The top 10 firms from a survey of the “100 Best Corporations for Working Mothers” included Abbott Laboratories, Accenture Ltd., Aflac Inc., Allstate Corp., American Express Co., Arnold & Porter LLP, AstraZeneca PLC, Avon Products Inc., Bank of America Corp., and Baptist Health South Florida.<sup>34</sup>

In the following sections, we turn to topics regarding how employers have and are experiencing and dealing with legal and ethical issues of changing workforces.

## 7.2 THE CHANGING SOCIAL CONTRACT BETWEEN CORPORATIONS AND EMPLOYEES

The social contract that has historically defined the employee/employer relationship is known as the *employment-at-will (EAW) doctrine*. Basically, the EAW holds that the employer can dismiss an employee at any time for any reason as long as federal and state laws and union contracts are not violated; likewise, employees are also free to terminate their employment with a company whenever they choose and for whatever reason. This doctrine remains the dominant view of the employment relationship in the U.S.,

although parts of the doctrine have eroded since its inception.<sup>35</sup> The EAW principle has been in effect since 1884, when the *Payne v. Western A.R.R. Co.* judgment ruled that “all may dismiss their employees at will, be they many or few, for good cause, for no cause, or even for cause morally wrong without being thereby guilty of legal wrong.” Essentially, the EAW doctrine can be defined as “the right of an employer to fire an employee without giving a reason and the right of an employee to quit when he or she chooses.”<sup>36</sup> If employees are unprotected by unions or other written contracts, they can be fired, according to this doctrine. As the insert “Read Carefully before Signing” shown in Figure 7.3 illustrates, employees can be and are asked to acknowledge how tenuous their “contract” with a company can be.

The EAW doctrine evolved as part of the laissez-faire philosophy of the Industrial Revolution. Between the 1930s and 1960s, however, exceptions to the doctrine appeared. Federal legislation since the 1960s has been enacted to protect employees against racial discrimination and to provide rights to a minimum wage, to equal hiring and employment opportunities, and to participation in labor unions. Over time, the following exceptions to the EAW doctrine have evolved: (1) a good faith principle, (2) public policy principle, and (3) implied contracts.

### Good Faith Principle Exception

Some states have other obligations that must be addressed by employers, like *good faith* or *fair dealing* practices.<sup>37</sup> A *good faith* principle is based on the premise that employers should practice fairness and reasonableness in their actions with employees. For example, an employer should demonstrate that opportunities were offered for a terminated employee to improve his/her performance before the employee was fired. Companies that demonstrate fairness in their dealings and policies with employees show good faith.<sup>38</sup>

### Public Policy Principle Exception

Since the 1970s, state court decisions have limited the EAW doctrine. Specifically, state courts have upheld employees’ rights to use legal action against their employers if an employee termination violated “*public policy*” principles; examples include (1) if employees were pressured to commit perjury or fix prices, (2) if employees were not permitted to perform jury duty or file for workers’ compensation, (3) if employees were terminated because they refused to support a merger, and (4) if employees reported alleged employer violations of statutory policy (whistle-blowing).<sup>39</sup>

### Implied Contract Exception

An important 1981 California Appeals Court decision, *Pugh v. See’s Candies, Inc.*, ruled that, in a noncontractual employment arrangement, an implied promise from the employer existed. The employer could not act arbitrarily with its employees regarding termination decisions when considering the following factors: (1) duration of employment, (2) recommendations and promotions received, (3) lack of direct criticism of work, (4) assurances given, and

(5) the employer's acknowledged policies.<sup>40</sup> Other implied contract exceptions include statements in employee and personnel handbooks, manuals, guidelines, letters offering employment, and verbal statements made to employees regarding job security and promises of continuing employment.<sup>41</sup>

Although the EAW doctrine has undergone change, it remains the cornerstone of U.S. labor law, as is illustrated in Figure 7.3 on the next page. States vary on the application of the EAW doctrine, but the U.S. Eighth Circuit Court of Appeals has favored employers. The federal court has stated that it

**Figure 7.3**

### Employee Contract under the EAW Doctrine

#### Read Carefully Before Signing

I understand that refusal to submit to the testing noted [elsewhere] or a positive drug screen result will eliminate any consideration for employment.

I also certify that the statements and information furnished by me in this application are true and correct. I understand that falsification of such statements and information is grounds for dismissal at any time the company becomes aware of the falsified notification. In consideration of my employment, I agree to conform to the rules and regulations of the company and acknowledge that my employment and compensation can be terminated, with or without cause, and with or without notice, at any time, at the option of either the company or myself. I further understand that no policy, benefit or procedure contained in any employee handbook creates an employment contract for any period of time and no terms or conditions of employment contrary to the foregoing should be relied upon, except for those made in writing by a designated officer of the Company.

I agree and hereby authorize XYZ, Inc. to conduct a background inquiry to verify the information on this application, other documentation that I have provided and other areas that may include prior employment, consumer credit, criminal convictions, motor vehicle and other reports. These reports may include information as to my character, work habits, performance, education and experience along with reasons for termination of employment from previous employers. Further, I understand that you may be requesting information from various federal, state and other agencies which maintain records concerning my past activities relating to my driving, credit, criminal, civil, and other experiences, as well as claims involving me in the files of insurance companies. I authorize all previous employers or other persons who have knowledge of me, or my records, to release such information to XYZ, Inc. I hereby release any party or agency and XYZ, Inc. from all claims or liabilities whatever that may arise by such disclosures or such investigation.

---

Date of Application

---

Signature of Applicant



will not act as a “superpersonnel board” of a company. Figure 7.3 is a copy of a contract an employee must sign before beginning work at this reputable company in Massachusetts. It is an example of a strongly worded EAW-oriented contract.

At issue in the EAW doctrine is the continuing debate over the nature of property and property rights. Each organization defines property rights and responsibilities offered to managers and employees, such as severance payments, pensions, stock options, access to resources, and golden parachutes. Employers also view employees’ labor, time, and effort as part of their property. At issue in the EAW doctrine is whether an employee’s education, skills, and other intangible assets are seen as the employee’s “property,” and if so, whether employees have certain rights regarding these assets. Due process is one such right that accompanies the EAW doctrine.<sup>42</sup>

The debate will continue over whose “property” and rights take precedence and whose are violated and on what grounds between employer and employee, especially in disputed firings that do not involve clear legal violations of employee rights, such as blatant discrimination. One scholar has noted that:

The present-day debate revolves mainly around utilitarian issues. To what extent is the welfare of society advanced by preserving or limiting the traditional prerogatives of employers? Employers typically favor employment at will not because they want to fire without cause but because they would rather avoid the need to account for their personnel decisions in court and face the possibility of stiff punitive awards. Even advocates of greater employee protection recognize the dangers of the courts becoming too deeply involved in business decision making.<sup>43</sup>

The next section presents employee rights and employer responsibilities and offers recommendations to managers for avoiding arbitrary termination decisions.

## 7.3 EMPLOYEE AND EMPLOYER RIGHTS AND RESPONSIBILITIES

Employers and employees have rights and responsibilities each should honor with respect to the other. This section discusses these mutual responsibilities, some of which stem from rights by law and legislation, while others are based on ethical principles. As discussed in Chapter 5, a values-based, stakeholder management approach views the employer–employee relationship as one grounded on mutual trust and reciprocal responsibility. Although laws and legislation serve the purpose of protection for both parties, without trust that is demonstrated in fair and equitable treatment of basic rights and responsibilities, one or both parties stand to lose. Nevertheless, not all employers or employees have a personal, professional, or organizational ethic that respects the other’s rights in all situations. Historical attitudes, negative prejudices, and stereotypes sometimes surface in institutionally unjust practices toward individuals and groups. On the other hand, employers must protect their property and assets against illegal and unethical practices of certain employees. When voluntary trust and mutual

respect fail and harm is done to employers or employees, the legal system can be evoked.

The EAW was a transition from a feudal European governance context to a modern pluralistic U.S. context. Employers still control private property and proprietary rights over their intellectual property. Employees claim their constitutional rights to individual freedom, liberty, and control over their private lives. Employers try to maximize productivity and profits, to sustain financial growth and stability, to minimize costs, to improve quality, to increase market share, and to stabilize wages. Employees seek to increase their wages and benefits, to improve working conditions, to enhance mobility, and to ensure job security while demonstrating mutual respect for the value of their labor. No perfect boundary exists between employer and employee rights in a capitalist market economy.

Before discussing specific rights and responsibilities between employers and employees, this section begins by defining “rights” and two premises based on this definition. Then two organizing concepts that underlie employee rights are suggested: balance and governmental rights. The concept of balance is based on utilitarian ethical reasoning and that of moral entitlement is based on Kantian nonconsequentialist reasoning. Although these concepts are not mutually exclusive, it is helpful to understand the logic behind them in order to argue their merits and shortcomings as they apply to specific workplace controversies.

## Moral Foundation of Employee Rights

The ideal relationship between employer and employees is one based on mutual respect and trust. Trust generally leads to open communication, which, in turn, provides an environment of collaboration and productivity. In many companies, this is, unfortunately, not the case. Power and authority relationships between employers and employees are, by definition, asymmetrical. Employees are generally, as stated by J. Rowan, in a “comparatively inferior bargaining position with respect to their employers. This inequity opens up possibilities for various sorts of exploitation, such as inadequate compensation, discrimination, and privacy invasions, all of which have been known to occur.” Rowan also notes that “employee rights are complex, in that managers, as a prerequisite for making ethically sound decisions, must assess which alleged employee rights are legitimate . . . and must weigh them against the rights of those in other stakeholder groups.”<sup>44</sup>

A right can be understood as a “moral claim.” A right is moral when it is not necessarily part of any conventional system, as are legal rights. A right is a claim because it corresponds with a duty on the part of the person against whom the right is held. For example, I claim that I have a right to be safe in my workplace. I hold this claim against my employer, because the employer has the duty to provide me with this safety. Under particular circumstances, my moral claim can be argued and disputed. It may not be an absolute claim.

The moral foundation for employee rights is based on the fact that employees are persons. One generic right that all persons have is a right to freedom, including the concept of negative freedom (i.e., the right not to be coerced or inhibited by external forces). Regarding employees, this right

to freedom is a claim “that when managers choose to hire employees, they must bear in mind that they are dealing with persons, and the (positive and negative) freedom of their employees is therefore to be respected.”<sup>45</sup> The second generic right of employees is the right to well-being. This right follows from individuals’ having interests, which are preconditions for pursuing goals. Interests and the pursuit of goals are morally important because they are not satisfied when a person does not have well-being. When employees cannot satisfy their job-related goals, interests, and requirements because of work-related conditions, an employee’s right to well-being may have been violated. With regard to these arguments on the moral foundation of employee rights, Sanford Jacoby has noted, “Employees should at all times be treated in a way that respects them as persons.”<sup>46</sup> We might add that the same observation holds true for employers; they also should be treated with respect as individuals.

### **The Principle of Balance in the Employee and Employer Social Contract and the Reality of Competitive Change**

As common law and custom have evolved from the EAW doctrine to implied employee rights, employers have the opportunity to consider more than stockholder and financial interests when dealing with employee stakeholders. As argued in Chapter 5, a values-based stakeholder management perspective views the employee–employer relationship from a “win–win” foundation. Both employers and employees act from a base of values. When the values of an organization align and draw on the values of employees, innovation, productivity, and individual, as well as corporate, productivity and development can occur.

In a highly competitive, globalizing environment in which intellectual skills, flexibility, and speed of work are emphasized, traditional views of company ownership and employee loyalty change. The evolving social contract between employers and employees still recognizes employers’ power over their physical and material property, but the contractual relationship between employer and employee aims in principle at *balance*, mutual respect, integrity, and fairness. The employer’s business interest can and should be balanced against the employee’s welfare, interests, and willing contribution to add value. In the early twenty-first century, small and mid-size employers are also pressured to balance global economic demands and tighter profit margins with employee interests. Larger firms continue to reduce their workforce and cut costs through outsourcing and offshoring, as discussed earlier in the text. Although employers generally have more power than employees in the contractual relationship, employees in the United States, for example, are still citizens under the protection of the Constitution. Employees must also balance their self-interests and motivations with the need of the organization to succeed, which is necessary for the organization to provide employment.

It is interesting to note that the principle of balance in the employer–employee relationship has been historically prevalent in some of the developed Asian countries, such as Japan, South Korea, Singapore, and Taiwan. In Japan, in particular, the Confucian tradition of harmony has

underscored the cooperative relationship between unions and companies.<sup>47</sup> European countries, including Germany and France, have also enacted laws that protect employee benefits and welfare. Some of these countries have traditions that include socialism and strong populist social policies. Some of these traditions and practices are also beginning to change under the competitive pressures of economic downturns, the use of information technology, and global competition. For example, lifelong employment in many Japanese companies is no longer guaranteed. Offshoring and outsourcing are now practiced at Sony, Matsushita, and Toshiba to mention a few firms.<sup>48</sup>

## Rights from Government Legislation

Employee rights are based on principles determined by law. Certain *government rights* (federal, state, and local) of the employee are not negotiable in written or implied contracts: for example, rights related to the minimum wage; sexual harassment; discrimination based on race, creed, age, national origin, gender, or disability; and the right to assemble. Although employee rights based on certain legislation are not always negotiated according to employer-employee self-interests, these rights can be disputed, depending on circumstances. Reverse discrimination, to be discussed later, is one such example. Although private corporations are the property of the owners, certain employee legal rights are still within a corporation's boundaries. (Refer back to Chapter 3 for a discussion of different classifications of moral rights.)

## Employer Responsibilities to Employees

Employers are obliged to pay employees fair wages for work performed and to provide safe working conditions. Review and answer the questions in the box entitled, "Who Has Rights in this Situation?" After you have answered and discussed the questions, what, if anything, did you learn about your and other classmates' values and beliefs regarding employee-employer responsibilities, obligations, and rights?

**Fair Wages** Fair wages are determined by factors such as what the public and society support and expect, conditions of the labor market, competitive industry wages in the specific location, the firm's profitability, the nature of the job and work, laws governing minimum wages, comparable salaries, and the fairness of the salary or wage negotiations.<sup>49</sup> As will be discussed in this chapter, fair wages for comparable jobs held by men and women are not always paid. "Women working full-time, year-round earn only about 77 cents for every dollar earned by men, virtually the same amount women earned in 2005. In 2006, the median annual earnings of women ages 15 and older working full-time, year-round were \$32,515, compared to \$42,261 for their male counterparts."<sup>50</sup> The wage gap is due to many reasons. But as one researcher noted, "Moving into male-dominated occupations in and of itself isn't the key to raising women's incomes. In none of the broad occupational categories do women make even 90% of what men make."<sup>51</sup>



## Who Has Rights in This Situation?

Aparna Jairam (a high-tech employee in India) isn't trying to steal your job (you're a high-tech U.S. employee). That's what she tells me, and I believe her. But if Jairam does end up taking it—and, let's face facts, she could do your \$70,000-a-year (U.S.) job for the wages of a Taco Bell counter-jockey—she won't lose any sleep over your plight. When I ask what her advice is for a beleaguered American programmer afraid of being pulled under by the global tide that she represents, Jairam takes the high road, neither dismissing the

concern nor offering soothing happy talk. Instead, she recites a portion of the 2,000-year-old epic poem and Hindu holy book, the Bhagavad Gita: "Do what you're supposed to do. And don't worry about the fruits. They'll come on their own."

### Questions

1. Do you agree with Aparna? Why or why not? Please explain.
2. On what, if any, ethical grounds could you either justify or reject her assessment? Explain.

**SOURCE:** Pink, D. (February 2004). The new face of the silicon age. *Wired Magazine*, 12(2), <http://www.wired.com/wired/archive/12.02/india.html>.

**Safe Working Environment** Employers also are obliged to provide workers with a safe working environment and safe working conditions. The Occupational Safety and Health Administration (OSHA) and federal laws and regulations provide safety standards and enforce employer institution of the company's own safety standards. The problems of employers providing—and of employees accepting—safe working environments stem from (1) lack of knowledge and of available, reliable information about levels of health risks; (2) lack of appropriate compensation proportional to the level of occupational risk; and (3) employees accepting known risks when the employer does not offer any safer alternatives.<sup>52</sup> When the option is employment versus no employment, workers, especially in low-income, noncompetitive employment regions, often choose jobs with hazardous risks to their health or life. Employees have a right to know about unsafe working conditions, as we also discuss later in the chapter.

Employers should pay competitive wages commensurate with the occupational risks associated with a profession, job, or work setting. For example, race car drivers would not be expected to receive the same pay as college professors. Employers also are expected to provide full information on the risks and health hazards related to the work, products, and working environments to all employees exposed to those risks. Finally, employers also should offer health insurance programs and benefits to employees exposed

to workplace hazards. Not all employers, especially with recent economic conditions, meet these obligations. Employers who cannot provide health and protection of employees in high risk, potentially unsafe environments should not be in that business.

**Working Conditions that Empower Employees** Although employers are not required by law to offer employees working conditions that provide meaningful tasks and job satisfaction, doing so can lead to increased performance, job satisfaction, and productivity. Employees work most productively when they can participate in the control of their tasks, when they are given responsibility for and autonomy over their assignments, and when they are treated with respect.<sup>53</sup> Quality of work life (QWL) programs that have provided employees with more autonomy, participation, satisfaction, and control in their work tasks have demonstrated positive results.<sup>54</sup> Many companies that have organized self-designing work teams, quality circles, and learning communities to tap into employee creativity and abilities have also provided opportunities for innovation. As noted in Chapter 5, there is an increase in companies offering opportunities for employees to practice their own religious and spiritual rituals during the work day. Employers and employees both gain when personal and organizational needs are met. Working environments that can provide conditions for this alignment are increasing in order to attract and retain talent.

## Employee Rights and Responsibilities to Employers

Employees are responsible for fulfilling their contracted obligations to the corporation; for following the goals, procedural rules, and work plans of the organization; for offering competence commensurate with the work and job assignments; and for performing productively according to the required tasks. Other responsibilities include timeliness, avoiding absenteeism, acting legally and morally in the workplace and while on job assignments, and respecting the intellectual and private property rights of the employer.

## Employee Rights in the Workplace

Labor, along with money and materials, is considered capital in a free-market system. However, labor is not the same as materials and money; labor also means human beings who have general constitutional rights that should not be relinquished between working hours.<sup>55</sup> Yet, clashes of interests and of stakes between employee rights and management demands frequently occur. The boundary between an employer's private property and an employee's individual rights is often blurred in everyday experience. Understanding employee rights is part legal and part ethical because these rights must be viewed and interpreted within corporate policy, procedures, and particular circumstances. In some instances, there are clear violations of an employee's rights; other times there are "gray," or uncertain, areas. When employees and employers cannot agree on whose rights are seriously violated, third-party negotiation, arbitration, and even settlement

may be required. This section presents major types of employee rights in the workplace:

- The right not to be terminated without just cause.
- The right to due process.
- The right to privacy.
- The right to know.
- The right to workplace health and safety.
- The right to organize and strike.
- Rights regarding plant closings.

These rights become even more important in a society that rapidly transforms technological and scientific inventions into part of the human workplace environment.

**Just Cause Termination** A basic principle in disciplinary termination cases is that the employer must have “just cause” for imposing the action. A test for determining whether there is “just cause” was developed by Arbitrator Daugherty in the celebrated *Enterprise Wire* case (46 LA 359, 1966 and 50 LA 83). An absolute “no” answer to any one or more questions in this guideline indicates that the employer’s action was “arbitrary, capricious and/or discriminatory in one or more respects, thereby signifying an abuse of managerial discretion and allowing the arbitrator to substitute his judgment for that of the employer.”

1. Was the employee adequately warned of the consequences of his conduct?
2. Was the employer’s rule or order reasonably related to efficient and safe operations?
3. Did management investigate before administering the discipline?
4. Was the investigation fair and objective?
5. Did the investigation produce substantial evidence or proof of guilt?
6. Were the rules, orders, and penalties applied evenhandedly and without discrimination to all employees?
7. Was the penalty reasonably related to the seriousness of the offense and the past record?<sup>56</sup>

As a principle, it also has been argued that workers should have three rights regarding work to maintain self-respect:

- The right to employment
- The right to equal opportunity
- The right to participate in job-related decisions<sup>57</sup>

These rights are less entitlements than goals and depend on market conditions. Just cause termination is problematic when other forms of employer discrimination are determined, such as discrimination in age, gender, disability, race, national origin, and other Title VII areas. For example, an Ohio jury awarded a 68-year-old woman \$30.6 million in an age discrimination lawsuit after a jury ruled that the company violated her rights by refusing to give her another job within the company when it terminated her from her management position.<sup>58</sup>

**Due Process** Due process is one of the most important underlying rights employees have in the workplace because it affects most of their other rights. Due process refers to the right to have an impartial and fair hearing regarding employers' decisions, procedures, and rules that affect employees. As applied in the workplace, due process essentially refers to grievance procedures.

At a more general level, due process rights protect employees from arbitrary and illegitimate uses of power. These rights are based on the Fifth and Fourteenth Amendments of the Constitution, which state that no person shall be deprived of "life, liberty, or property, without the due process of law."

Patricia Werhane<sup>59</sup> states that the following corporate procedural mechanisms are needed to ensure employees' right to due process:

- Right to a public hearing
- Right to have peer evaluations
- Right to obtain external arbitration
- Right to an open, mutually approved grievance procedure

The right to due process applies to other employee rights, such as those involving privacy; safety and health; safe working environments; holding meetings and gatherings; and hiring, firing, and other human resource decisions.

**Right to Privacy** Employees' right to privacy remains one of the most debated and controversial rights. It raises these questions: Where does the employer's control over employee behavior, space, time, and property begin and end? What freedoms and liberties do employees have with employer property rights? What rights do employers have to protect their private property, earnings, and costs from employees? The U.S. Constitution does not actually refer to a person's right to privacy; the working definition of employees' right to privacy has come to mean "to be left alone." Privacy in the workplace also can refer to employees' right to autonomy and to determine "when, how, and to what extent information about them is communicated to others."<sup>60</sup> The extent of an employee's privacy in the workplace remains an unsettled area of controversy. The definition of what constitutes an employee's privacy is still somewhat problematic, including the notion of psychological privacy (involving an employee's inner life) and the notion of physical privacy (involving an employee's space and time).<sup>61</sup> In the 1965 *Griswold v. Connecticut* case, the Supreme Court ruled that the Constitution guarantees individuals a "zone of privacy" around them into which the government cannot intrude. Proponents of this definition argue that this zone includes personnel records and files and protection against polygraph and psychological testing and surveillance in the workplace. The ruling also is intended to protect employees in their after-work activities; their need for peace and quiet in the workplace; their dress, manners, and grooming; and their personal property in the workplace. Identifying this "zone of privacy" has proved complicated, especially in cyberspace and the use of technological surveillance.



**Technology and Employee Privacy** Although employee privacy rights remain largely undefined regarding uses and abuses of emerging technologies in the workplace, the following main types of court-upheld privacy violations and permissible employee privacy inquiries can serve as guidelines. Court-upheld privacy violations include:

1. Intrusion (locker room and bathroom surveillance)
2. Publication of private matters
3. Disclosure of medical records
4. Appropriation of an employee's name for commercial uses
5. Eavesdropping on employee conversations and retrieving or accessing employee e-mail (if unauthorized)

Permissible employee privacy inquiries include:

1. Criminal history inquiries
2. Credit history inquiries
3. Access to medical records<sup>62</sup>

**Conflicts of Interest** Employee responsibilities to employers become complicated when conflicts of interest appear, that is, when an employee's private interests compete or are not aligned with the company's interests. More obvious conflicts of interest arise in a number of situations, such as taking or offering commercial or personal bribes, kickbacks, gifts, and insider information for personal gain.

The so-called gray areas are more problematic for determining whose interests are violated at the expense of others: for example, an employee quits a firm, joins a competitor, and then is accused by the former employer of stealing proprietary property (that is, passing on intellectual property, sharing trade secrets, or offering a competitive advantage by divulging confidential information). Whose interests are violated?<sup>63</sup> Some courts have used a "balancing model" based on utilitarian logic to resolve trade-secret-protection cases; that is, an employee's interest in mobility and opportunity is weighed against the employer's right to decide the extent of protection given to confidential information. For example, the following three criteria have been used to decide whether trade secrets have been divulged by employees:

1. True trade secrecy and established ownership must be shown.
2. A trade secret must have been disclosed by an employee, thus breaching a duty of confidentiality.
3. The employer's interest in keeping the secret must outweigh the employee's interest in using the secret to earn a living and the public's interest in having the secret transmitted.

Courts also use other considerations in these types of rulings (for example, contract obligations, promises made, truthfulness, confidentiality, and loyalty). The point here is that as technology and expertise become more sophisticated and as employee mobility—and downsizing—increase, workplace and courtroom criteria regarding the proof of conflict of interest also grow more complicated. Although a utilitarian model is used to help determine

conflict-of-interest court cases, such as trade secrecy, ethical principles such as rights, duty, and justice also remain essential considerations for determining right and wrong; violations of loyalty, confidentiality, or truthfulness; and harm done to either employers or employees.

## Other Employee Rights and Obligations to Employers

**Polygraph and Psychological Testing** Employers are particularly concerned about employee privacy rights regarding testing. Polygraph and psychological testing and other related techniques that many managers would like to use to prevent and detect crime in the workplace may constitute a violation of employee rights. Workplace theft has been estimated by the U.S. Department of Commerce to cost in excess of \$40 billion a year in the United States.<sup>64</sup> Here are some of the issues surrounding the use of polygraphs and psychological testing:

1. These tests are not reliable or valid; they are only indicators.
2. The tests, to some extent, can be manipulated and influenced by the operators.
3. The tests may include irrelevant questions (such as those pertaining to gender, lifestyle, religion, and after-work activities) that invade a person's privacy.
4. Employees do not have control over the test results or how the information is used.

Researchers in the field of honesty testing have concluded that only 1.7% (at worst) to 13.6% (at best) of such tests are accurate.<sup>65</sup>

**Workplace Surveillance** Surveillance of employees at work (that is, employers using technology to spy on and invade workers' privacy) is also a subject of concern. Software programs are used to monitor workers who use computer terminals.<sup>66</sup> While there are pros and cons of surveillance videos in the workplace, as the Ethical Insight insert here shows, there are no clearcut answers as to whether or not to use such equipment to monitor employee performance. Employers can detect the speed of employees' work, number and length of phone calls made and received, breaks taken, when machines are in use, and so on. Although some form of work-related monitoring is certainly legal and even necessary, the ethical issues that the American Civil Liberties Union (ACLU) raises are the possible invasion of employee privacy and fair treatment. What type of information does an employer have a right to, and what effects do stress and anxiety from monitoring have on employee welfare? The Electronic Communications Privacy Act renders electronic eavesdropping through computer-to-computer transmissions, private videoconferences, and cellular phones illegal.

A study released by the Society for Human Resource Management, a trade association in Alexandria, Virginia, showed that 80% of the organizations in the study used e-mail. Only 36% of those groups had policies concerning e-mail use and only 32% had written privacy policies. The issue of individual employee privacy remains somewhat undefined in the workplace.<sup>67,68</sup>

ETHICAL INSIGHT 7.2

Pros and Cons of Employers Using Video Surveillance

Pros	Cons
<p><b>Increased safety:</b> Improves the security of employers and employees.</p> <p><b>Theft deterrent:</b> Saves companies by preventing stolen products.</p> <p><b>Prompts good behavior:</b> Monitoring can encourage productive behavior</p> <p><b>Provides evidence of a crime:</b> Proof of stolen goods can be provided with electronic monitoring.</p>	<p><b>Potential invasion of privacy:</b> Camera installation in improper locations and video footage monitored and stored inappropriately presents liability for invasion of privacy claims and costly legal actions.</p> <p><b>Can provide false sense of security.</b></p> <p><b>Lowers morale:</b> Can promote a lack of trust, negatively affecting an employee work performance.</p>

Questions

1. How would electronic video surveillance affect you and your performance in the workplace?
2. Can you identify with an employer’s need and justification for this equipment? Explain.
3. What other means of monitoring employee performance would you recommend and why?

**SOURCE:** Lynn Bryant. (October 12, 2006). What are the pros and cons of monitoring employees using video surveillance? <http://www.video-surveillance-guide.com/monitoring-employees-using-video-surveillance.htm>.

**Internet Use in the Workplace** This is another undefined area regarding employee use of technology that requires the employer’s development of “appropriate use policies,” or AUPs. Millions of messages are estimated to pass through the Internet every hour. Instant messaging (IM: real-time text conversation that takes place in private online chat areas) is growing in the workplace and causing companies problems. Fifty-three million adult Internet users traded instant messages in 2004, up 29% from 2000. Among users who are 18 to 27 years of age, 46% use IM more than e-mail. Employers are concerned about IM informal conversations that waste time.<sup>69</sup>

Jo Tucker, head of labor and employment practices at Morrison and Foerster, a law firm based in Irvine, California, stated that “if a worker is using a computer in a company office, on company time, privacy is what the employer says it is.”<sup>70</sup> Without AUPs, Internet use in the workplace remains a guessing game between employer and employee. An employee

Internet use policy depends on the company, its corporate culture, and the nature of its business. The policy must have the involvement and endorsement of top-level leadership. Monitoring capability, with employee awareness, must also accompany the policy. As J. Martin states, “A clear AUP policy effectively removes employee expectations of privacy on the Internet, eliminating potential lawsuits.”<sup>71</sup> All use policies should also be spelled out clearly with no ambiguities and with simple, easy, enforceable rules. Part of such a policy involves the security of data for the entire company, because the reputation of the system and violations of it involve not only employees but also all stakeholders. A policy on Internet use can help companies in the following ways: (1) save employee work time; (2) prevent tying up phone lines and computer disk space that could be used for vital company business; (3) prevent exposing sensitive company data stored on computers to outside attack; and (4) prevent creations of conditions that enable employee harassment of each other and, ultimately, of the company.

Guidelines offered to employers regarding employee privacy include:

- Inform employees not to assume privacy in the workplace.
- Require employees to acknowledge the company’s privacy policy in writing.
- Use private information only for legitimate purposes.
- Limit access to private information about employees to only those with a need to know.
- Secure employee medical records separately from other personnel files.
- Obtain signed permission releases and waivers before using an employee’s name or photograph in any commercial advertisement, promotional material, or training film.<sup>72</sup>

**Dating in the Workplace** As employees spend more time in the workplace, it is not uncommon for attraction and dating to occur. A 2003 survey of 390 managers and executives by the AMA (American Management Association) found that 30% reported they had dated a co-worker, and two-thirds said employees’ dating in the workplace was not prohibited. “Of those 67%, 96% said it was okay to date co-workers, and 24% said it was okay for employees to date their bosses.”<sup>73</sup> Issues arise whenever problems in the dating relationships occur. Gossip, accusations, even sexual harassment complaints can and do occur. Guidelines offered in Figure 7.4 can help protect both employers and employees.

**Drug Testing and Privacy Rights** Privacy is also an issue in drug testing. Advocates for employee drug testing argue that company health costs and costs associated with sick and lost (nonproductive) days are affected when employees contract serious diseases, such as AIDS, or suffer from drug and alcohol addiction. Also, in industries (such as the airline industry or nuclear plant operations) where drug abuse can cost the lives of innocent people, screening drug abusers is viewed as in the public interest. Those who oppose forced employee drug testing argue that the practice violates employees’ rights to due process and privacy.

● Figure 7.4

### Quick Tips for Office Romance

1. Know your company's policy. Dating a co-worker is not illegal, but if it violates your office's policy, it could get you fired. Check with your human resources department or make some discreet inquiries.
2. Test the waters. Don't jump headfirst into an office fling. Take time to weigh all considerations and possible consequences.
3. Establish some ground rules. Talk to your partner early on about how you plan to handle the relationship and what you would do if things turn sour. Make sure you're both on the same page.
4. Be considerate and professional. Even if your co-workers are accepting of the relationship, no one wants to see public displays of affection. Blatant flirting or physical contact could make you fodder for gossip, too.
5. Stay focused on your job. Being in love is distracting. But don't let the relationship detract from your professional responsibilities.
6. Don't play favorites. Of course you want to protect your loved one's interests, but don't let your bias seep into the office. Consider avoiding tasks where a conflict of interest might develop.
7. Be honest. No matter how cautious you are, the secret's bound to get out. Be prepared to confirm the rumor and plan on telling your boss that you will keep your relationship professional at work.
8. Proceed with caution. Lawsuits and sexual harassment issues are always a possibility if the relationship creates a hostile work environment or causes discrimination or special treatment of any kind. Be extra cautious if you're considering a romantic relationship with a boss or a subordinate. Many company policies specifically forbid liaisons between upper- and lower-level employees.

**SOURCE:** Minarcek, A. (June 29, 2004). Taboo on office romance fading. Cox News Service, <http://www.azcentral.com/ent/dating/articles/0629officeromance29.html>. Reprinted with permission.

The following guidelines can be used by companies for policy development in drug-testing programs:<sup>74</sup>

1. Tests should be administered only for jobs that have a clear and present potential to cause harm to others.
2. Procedural testing limitations should include previous notice to those being tested.
3. Employees tested should be notified of the results.
4. Employees tested should be informed that they are entitled to appeal the results.
5. The employer should demonstrate how the information will be kept confidential (or destroyed).

Four steps managers can take to develop corporate policy guidelines to prepare for privacy regulation in general are:<sup>75</sup>

1. *Prepare a “privacy impact statement.”* An analysis of potential privacy implications should be part of all proposals for new and expanded systems.
2. *Construct a comprehensive privacy plan.* The privacy impact statement provides the input for planning; the plan specifies all that has to be achieved.
3. *Train employees who handle personal information.* Make employees aware of protecting privacy and of the particular policies and procedures that should be followed.
4. *Make privacy part of social responsibility programs.* Keep organizational members informed about company plans regarding privacy issues, with or without regulatory pressures.<sup>76</sup>

**Genetic Discrimination** Should employers perform DNA testing on employees when several areas of discrimination could surface? Two examples are: (1) Employment based on a person’s predisposition to a disease could negatively and unfairly affect hiring, firing, and benefits; and (2) Insurance companies that could obtain an employee’s genetic information would also be able to deny a person certain benefits. One lawsuit, settled in April 2001, was filed against Burlington Northern Santa Fe Railway Company in Fort Worth, Texas. The railroad agreed to stop genetic testing. Testing had been required for those employees who filed claims for carpal tunnel syndrome. On the other hand, if scientists can master stem cells to tailor-make organ or tissue transplants to understand and eventually treat the underlying mechanisms of diseases, why shouldn’t the federal government fund this research and practice?

The Genetic Nondiscrimination in Health Insurance and Employment Act was introduced by Senator Thomas Daschle of South Dakota and Congresswoman Louise Slaughter of New York in 2001. This Act would prevent genetic testing of employees. President Bush’s reported interest regarding genetic discrimination has been about placing a cap on damages that might arise from such lawsuits, although he did sign legislation in 1997, while he was governor of Texas, that prohibited genetic discrimination in employment and group health plans.<sup>77</sup> The testing and use of genetic information of employees remains to be fully defined and enforced in the workplace and in legislation.<sup>78</sup>

**The Right to Know and Workplace Health and Safety** Every employee is entitled to a safe, healthy workplace environment, because one of ten employees in private industry suffers from an industrial accident or disease while working. Information about unsafe, hazardous workplace conditions and some form of protection from these hazards are needed.<sup>79</sup> Employees have a right to know the nature and extent of hazardous risks to which they are exposed and to be informed and trained about and protected from those risks. Right-to-know laws have been passed in 20 states since the mid-1980s.<sup>80</sup>

The Occupational Safety and Health Administration (OSHA) is the federal agency responsible for researching, identifying, and determining workplace health hazards; setting safety and health standards; and enforcing

the standards. These remain major tasks. Critics of OSHA claim they are too overwhelming for one agency to monitor and execute effectively. The missions and budgets of government regulatory agencies—including OSHA—are also a function of the politics of the governing administration and Congress.

**Smoking in the Workplace** Legislation has, or is projected to, ban smoking in public places including workplaces in several countries including the U.S.<sup>81</sup> Among stakeholders who have argued and lobbied against smoking in the workplace are the Environmental Protection Agency (EPA), OSHA, and ASH (Action on Smoking and Health—the powerful national antismoking group). Pro-smoking advocates include the tobacco industry and its lobbying group, the Tobacco Institute, and the Bakery, Confectionery, and Tobacco Workers union. OSHA has not been able to place an absolute ban on smoking in all workplaces to date, even though tobacco has been shown to be one of the leading causes of death. The issue reflects societal habits and attitudes and the politics and economics of the industry.<sup>82</sup>

Consider these facts: It is estimated that 28% of Americans age 18 and over are smokers. Approximately 80% of workers are protected to some extent by a workplace policy, and nearly half of all indoor workers are employed in smoke-free workplaces. Twenty states and the District of Columbia have laws that restrict smoking in private-sector workplaces.<sup>83</sup> Almost 75% of 1,794 facility managers in a survey claim they ban or segregate smoking in their workplaces.<sup>84</sup> One of OSHA's strategies has been to link smoking in the workplace to indoor air-quality problems and pollution and to legislate against it. The Clean Air Act is one such move to further restrict indoor smoking in public facilities. Employers need to keep track of laws and regulations that affect employee rights regarding smoking in the workplace.

**The Right to Organize and Form Unions** Workers have a right to organize, just as owners and managers do. Individuals, as workers and citizens, have the right of free association to seek common ends. This also means employees have a right to form unions. Although unions have a right to exist, they have no special rights beyond those due organizations with legal status.<sup>85</sup>

**Plant Closings and Employee Rights** Companies have the right to relocate and transfer operations to any place they choose. If firms can find cheaper labor, raw materials, and transportation costs; lower taxes; no unions; and other business advantages for making a profit elsewhere, they often close plants and move. Companies also close plants because of loss of competitiveness, financial losses, and other legitimate economic reasons. The ethical questions posed to corporate managers regarding plant closings are: What rights do the employees who are affected by the closing have? What responsibilities does the company have toward the affected communities, and even toward the national economy?

Since August 1988, companies with more than 100 employees must by law give 60 days notice to workers before closing. Employees also have moral rights—to be treated fairly, equally, and with justice—when companies decide to relocate or close. Employees have the right to be compensated for the costs of retraining, transferring, and relocating; they have rights to severance pay and to outplacement and support programs that assist them in finding alternative employment; and they have the right to have their pension, health, and retirement plans honored.<sup>86</sup>

Employees also should be given the right to find a new owner for the plant and to explore the possibility of employee ownership of the plant before it is closed.<sup>87</sup> These rights extend beyond workers and include the welfare of the communities where the plant operates. Plant closings affect jobs, careers, families, and the local tax base, and can even negatively affect the regional and national economies, when sizable operations are shut down or moved abroad.

Whatever the motivations for corporate closings or transfer of facilities, the rights of employees and local community groups stand, even though these rights are often negotiated against the utilitarian interests of corporations in specific economic contexts. As mentioned earlier, with globalization and increased pressures on corporate profits, plant closings have become almost commonplace. Responsible employers keep employees informed of planned facility closings.<sup>88</sup>

**The Family and Medical Leave Act** The Family and Medical Leave Act (FMLA) was enacted into law in 1993, eight years after it was introduced in Congress by Christopher Dodd, William Clay, and Patricia Schroeder. The final rules were established in 1995. The FMLA entitles eligible employees to a maximum of 12 weeks of unpaid leave per year for the birth or adoption of a child, to care for a spouse or immediate family member with a serious health condition, or when an employee is unable to work because of personal illness. The 12 weeks need not be used consecutively because intermittent leave or reduced work schedules are allowed under the act. To be considered eligible, an employee must have been employed for a continuous 12-month period and for at least 1,250 hours during the year preceding the leave.

Companies that employ at least 50 people within a 75-mile radius are mandated to offer such leave. The employer is required to maintain any preexisting health coverage during the leave. Once the leave is concluded, the employee must be reinstated to the same position or an equivalent job. An equivalent position must have the same pay, benefits, working conditions, authority, and responsibilities.

Employers have the right to request a 30-day advance notice for foreseeable absences and may require employees to present evidence to support medically necessary leave. Employers may request employees to obtain a second medical opinion at the employer's expense. Employers may deny reinstatement of employment to "key employees." Such employees must be among the 10% highest paid company employees, and their absence must have a serious economic impact on their organization. It is the duty of employers to inform employees of their status as "key employees" when they request a leave.



Major problems with the FMLA, from employees' experience, have been serious illnesses (e.g., *Price v. City of Fort Wayne*); from employers' perspective, rising health and company costs; and from government's viewpoint, administrative requirements (e.g., *Viereck v. City of Gloucester City*). Employers often unintentionally violate the sometimes confusing and contradictory FMLA.<sup>89</sup> The courts have also tended to rule in favor of employees who have less serious and even minor illnesses. Finally, based on a seven-year study of more than 7,500 adults, it was found that the burden of not having a national or state-by-state family paid leave policy falls heaviest on the middle class and the working poor. Although 40% of Americans in the top quartile of income lacked a sick leave policy at work, 54% of Americans in the second quartile, 63% in the third quartile, and 76% of workers in the bottom quartile lacked sick leave. Although 41% of working parents in the top quartile of income have 2 weeks or less of sick leave and vacation leave, 57% of parents in the second quartile, 68% in the third quartile, and an astounding 84% in the bottom quartile had 2 weeks or less of sick and vacation leave.<sup>90,91</sup>

## 7.4 DISCRIMINATION, EQUAL EMPLOYMENT OPPORTUNITY, AND AFFIRMATIVE ACTION

It is difficult to imagine that throughout most of the 19th century, women in America could not vote, serve on juries, issue lawsuits in their own name, or initiate legal contracts if they lost their property to their husbands. In an 1873 Supreme Court decision, *Bradwell v. Illinois*, a woman had “no legal existence, separate from her husband, who was regarded as her head and representative in the social state.”<sup>92</sup>

It is also difficult to imagine the legal status of black people in the United States in 1857. In the Dred Scott case, one of the opinions of the Supreme Court considered blacks as “beings of an inferior order . . . and so far inferior that they had no rights that the white man was bound to respect.”<sup>93</sup>

More recently, discrimination has surfaced in a number of categories. Racial profiling remains an issue. Black individuals are more likely to be stopped and arrested by police than whites. Income disparities between whites and minorities continue to rise. The average income of a black family was 65% of a white family's income; in 1994, that percentage was 63%.<sup>94</sup> The ratio of women's annual pay to men's for full-time employment was 83.8 cents on the dollar during the last decade. Women still make, on average, 76 cents on the dollar for comparable work compared with men.<sup>95</sup> It is against this background that the doctrines, laws, and policies of discrimination, equal opportunity, and affirmative action must be considered.

### Discrimination

Discriminatory practices in employer–employee relationships include unequal or disparate treatment of individuals and groups.<sup>96</sup> Unequal or preferential treatment is based on irrelevant criteria, such as gender, race,

color, religion, national origin, or disability. Systematic and systemic discrimination is based on historical and institutionally ingrained unequal and disparate treatment against minorities, the disadvantaged, and women.

Examples of contemporary and systemic discrimination in employer–employee relationships are found in practices such as recruitment, screening, promotion, termination, conditions of employment, and discharge.<sup>97</sup> These practices are attributed to closed employment systems and practices resulting from seniority systems, “old boy networks,” and arbitrary job classifications. Recruiting procedures that are biased toward certain groups and that do not openly advertise to minority groups are discriminatory. Screening practices that exclude certain groups and that use biased tests or qualifications are discriminatory. Promotion procedures that have “glass ceilings” (i.e., invisible discriminatory barriers to advancement) for women and minority groups are discriminatory.<sup>98</sup> Seniority tracks that favor white males or other groups over minorities or women are discriminatory. Terminating employees on the basis of sex, age, race, or national origin is discriminatory. Since September 11, 2001, Middle Eastern individuals have faced greater discrimination in the U.S.

On October 26, 2001, President Bush signed the USA Patriot Act into law. The intent of the Act is to unite and strengthen America by “providing appropriate tools required to intercept and obstruct terrorism.” “While many of its provisions were designed to bolster domestic security and enhance surveillance procedures, etc., Title III of the Act, ‘International Money Laundering Abatement and Anti-Terrorism Financing Act of 2001,’ contains many new provisions and amendments to the Bank Secrecy Act and the Money Laundering Control Act of 1986. These will affect how both financial and non-financial institutions do business.”<sup>99</sup>

The Act is constantly evolving, adding new requirements and compliance procedures. Provisions are intended to establish anti-money laundering compliance programs. “The legislation adds new crimes which are prerequisites to the crime of money laundering. These include terrorism, foreign corruption, certain export controls, certain foreign crimes and extraditable offenses.”<sup>100</sup> The costs and complexities of implementing these laws have been and are challenging many banks and other financial institutions to stretch beyond their original mission, means, and capabilities. Although the intent is praiseworthy, ethical questions remain: “To what extent will these laws protect or punish the innocent, including the business institutions who are the implementers?”

## **Equal Employment Opportunity and the Civil Rights Act**

Title VII of the Civil Rights Act of 1964 makes discrimination on the basis of gender, race, color, religion, or national origin in any term, condition, or privilege of employment illegal. The law prohibits discrimination in hiring, classifying, referring, assigning, promoting, training, retraining, conducting apprenticeships, firing, and dispensing wages and fringe benefits. The Civil Rights Act also created the Equal Employment Opportunity Commission (EEOC) as the administrative and implementation agency to investigate complaints that individuals submit. The EEOC negotiates and works with

the Justice Department regarding complaints; however, the EEOC cannot enforce the law except through grievances.

The Civil Rights Act of 1991 extended, for the first time, punitive damages to victims of employment discrimination. This law states that job bias on the basis of gender, disability, religion, or national origin will be punished as severely as job discrimination based on race. It also makes it easier for job-bias plaintiffs to win lawsuits. This legislation shifts the legal burden of proof to the employer, who must defend any intentional or unintentional employment bias, especially if the practice in question has a “disparate impact” on minorities or women. Under this law, the employer must demonstrate that the alleged discriminatory act is “job-related for the position in question and consistent with business necessity.”<sup>101</sup> “Job-related” and “business necessity” are undefined and are determined by the courts. The act specifies that employers with more than 500 employees could be liable for up to \$300,000 in compensatory and punitive damages. Smaller companies are liable for less, depending on the number of workers they employ.

The Equal Employment Opportunity Act of 1972 amended the 1964 act to empower the EEOC to enforce the law by filing grievances from individuals, job applicants, and employees in the courts. All private employers with 15 or more employees fall under the jurisdiction of the revised act, with the exception of bona fide tax-exempt private clubs. All private and public educational institutions and employment agencies are covered by the law. Labor unions (local, national, and international) with 15 or more members are included. Joint labor-management committees that administer apprenticeship, training, and retraining programs are also under this law’s jurisdiction.

There were 58,124 charges filed through Title VII in 2000, which resulted in recovery of \$149 million in monetary benefits to workers who had been discriminated against.<sup>102</sup>

## Age and Discrimination in the Workplace

The Age Discrimination in Employment Act (ADEA) of 1967, revised in 1978, prohibits employers from discriminating against individuals based on their age (between ages 40 and 70) in hiring, promotions, terminations, and other employment practices. In 1987, ADEA again was amended when Congress banned any fixed retirement age. The EEOC also issued a final rule in 2001 that aimed at prohibiting contracts requiring terminated employees to give back severance benefits if they challenged their terminations under the ADEA. “The new regulation takes effect at a time when several large corporations have announced significant layoffs. In recent years, companies have increasingly tried to tie severance deals during mass terminations to waivers of ADEA rights, as many employees who lose their jobs in such actions are over 40 and covered by the statute.”<sup>103</sup>

Age discrimination also applies to younger individuals. Hanigan Consulting Group of New York surveyed 170 recent graduates, some scheduled to receive master’s and doctoral degrees. The firm found that some applicants were asked questions that clearly violated antidiscrimination laws;

for example: Do you intend to get married and have children? What will your boyfriend think of you working long hours? How old are you? Are you married? The basic guideline, according to a Boston attorney with Seyfarth, Shaw, is “if the question is not business-related and there is no legitimate business reason for asking it, then do not ask it.”<sup>104</sup>

## Comparable Worth and Equal Pay

The Equal Pay Act of 1963, amended in 1972, prohibits discriminatory payment of wages and overtime pay based on gender. The law, in large part, is based on the doctrine of “comparable worth.” This doctrine and the Equal Pay Act hold that women should be paid wages comparable to men who hold jobs that require equal skill, effort, and responsibility and that have the same working conditions. This law addresses this inequity and also applies to executive, professional, sales, and administrative positions. In 2000, President Clinton failed to get the Paycheck Fairness Act into legislation. That act would have enabled the EEOC to collect and monitor data on pay and compensation from employers based on gender, race, and national origin. Fines could have been levied against companies with unequal pay scales. The Republican-led Congress would not have likely passed the act had it been proposed by the Clinton Administration.<sup>105</sup> While women have made substantial professional progress over the past 30 years, those gains now seem to have lost momentum and even stalled. “Key indicators such as pay, board seats, and corporate-officer posts all reflect a leveling off or drop in recent years. Although the gap between men’s and women’s pay narrowed significantly through the 1980s, gains since then have been partly erased by a drop every few years. In 2006, women over the age of 25 earned 78.7 cents for every dollar earned by men, according to the most recent statistics from the U.S. Labor Department. That’s a decline from 2005’s figure of 79.4 cents on the dollar and also represents only about a 5-cent increase since 1991.”<sup>106</sup>

## Affirmative Action

*Affirmative action* programs are a proactive attempt to recruit applicants from minority groups to create opportunities for those who, otherwise, because of past and present discriminatory employment practices, would be excluded from the job market. Affirmative action programs attempt to make employment practices blind to color, gender, national origin, disability, and age. Although the doctrine of equal opportunity states that everyone should have an equal chance at obtaining a job and a promotion, affirmative action goes further. For example, Richard DeGeorge stated, “Affirmative action implies a set of specific result-oriented procedures designed to achieve equal employment opportunity at a pace beyond that which would occur normally.”<sup>107</sup>

Affirmative action programs were designed to set goals, quotas, and time frames for companies to hire and promote women and minorities in proportion to their numbers in the labor force and in the same or similar occupational categories within the company.

Courts have supported and eroded affirmative action approaches in the Civil Rights Act. Because of the changing social, political, and demographic landscape in the U.S., different membership on the Supreme Court, and evidence of reverse discrimination, changes in affirmative action law are occurring. Affirmative action remains a controversial topic and policy. Individuals' rights are violated when affirmative action programs seek to protect particular groups. Also, in a market economy where individual achievement based on merit is encouraged and rewarded, it seems unfair that arbitrary quotas should supersede those who do excel. On the other side of the controversy are advocates of affirmative action who claim that the playing field still is not level in U.S. corporate, educational, and other institutions whose officers select, hire, reward, and promote based on race, gender, national origin, ability, and other biases.

Four arguments that have been offered to explain and summarize affirmative action as it applies to hiring, promotions, and terminations are:

1. Affirmative action does not justify hiring unqualified minority group members over qualified white males. All individuals must be qualified for the positions in question.
2. Qualified women and minority members can be given preference morally, on the basis of gender or race, over equally qualified white males to achieve affirmative action goals.
3. Qualified women and minority members can be given preference morally over better-qualified white males, also, to achieve affirmative action goals.
4. Companies must make adequate progress toward achieving affirmative action goals even though preferential hiring is not mandatory.<sup>108,109</sup>

## Ethics and Affirmative Action

The ethical principles behind affirmative action are often debated. Affirmative action as a doctrine is derived from several ethical principles that serve as bases for laws.

First, the *principle of justice* can be used to argue for affirmative action, by claiming that because white males have historically dominated and continue to unfairly dominate the highest paying, most prestigious employment positions in society, members of groups who have been excluded from comparable employment opportunities because of past and present discriminatory practices deserve to be compensated through affirmative action programs embodied in equal opportunity laws. Opponents of affirmative action argue that it is unfair and unjust that the distribution of benefits be based only on a few categories (race, sex, ethnicity) rather than on achievement or other criteria.

Second, a *utilitarian principle* can be used to support affirmative action by claiming that such programs help the majority of people in a society. Opponents argue that affirmative action cannot be shown or proven to work, and suggest that its benefits do not exceed its costs.

Finally, using a *rights principle*, proponents of affirmative action can argue that protected groups have a right to different treatment because

these groups have not had equal or fair access to benefits as other groups have. In fact, the rights of minorities, women, and other underprivileged groups have been denied and violated regarding access to education, jobs, and other institutional opportunities. Opponents using the rights principle argue that the rights of all individuals are equal under the law. The controversy continues as the economic, social, political, and demographic environments change.

## **Reverse Discrimination: Arguments against Affirmative Action**

Arguments against affirmative action are directed toward the doctrine itself and against its implementation of quotas. The doctrine has been criticized on the grounds that nondiscrimination requires discrimination (that is, reverse discrimination). Reverse discrimination is alleged to occur when an equally qualified woman or member of a minority group is given preference over a white male for a job or when less qualified members of an ethnic minority are given hiring preference over white males through a quota system. Affirmative action, opponents argue, discriminates against gender and race, that is, white males. Some even say affirmative action discriminates against age: white, middle-aged males.

Another major argument against affirmative action says that individuals are held responsible for injustices for which they were not and are not responsible. Why should all contemporary and future white males, as a group, have to compensate for discriminatory practices others in this demographic category once committed or now commit?

Although these claims have some validity, proponents of affirmative action argue that injustices from discrimination have been institutionalized against minority groups. It happens that white males continue to benefit from the competitive disadvantages that past and present discriminatory practices have created for others. To compensate and correct for these systemic disadvantages based on race, gender, and other irrelevant (i.e., not related to employment) characteristics, social affirmative action goals and programs must be implemented. Still, the law is not a perfect means to correct past or present injustices. People of all races will continue to be hurt by discrimination and reverse discrimination practices. In the meantime, the court system will continue to use civil rights laws, affirmative action guidelines, and moral reasoning to decide on a case-by-case basis the justice and fairness of employment practices.

In June 2002, the Supreme Court upheld the equal protection clause of the 14th Amendment that guarantees equal treatment under the law by condoning the University of Michigan Law School's practice of using race to help integrate the institution's student body. The second Supreme Court opinion ruled that the admissions program in the university's undergraduate school violated the equal protection clause of the Constitution by giving minorities a bonus of 20 points in a 150-point system for race. "Two white students have sued the university claiming they were denied admission in favor of less-qualified minorities before the Supreme Court ruled.

ETHICAL INSIGHT 7.3

The Pros and Cons of Affirmative Action

**Affirmative action:** Policies and procedures designed to make education and employment opportunities available to minority men and women of all races. Also created to address inequalities of

present and past historical and institutional discrimination preventing persons of different races from access to education and employment in schools, universities, police and fire departments, and other public offices as well as jobs in the private sector.

Affirmative Action	
Opponents	Advocates
1. Perpetuates reverse discrimination.	1. Helps “level the playing field” by providing access to education and jobs that minorities and less advantaged groups would not otherwise be able to obtain.
2. Promotes the less qualified over the more qualified, instead of opening doors to the historically underrepresented.	2. Integrates otherwise closed institutions and corporations with individuals from diverse groups more reflective of the general population.
3. Perpetuates repressed groups continuing to be underprivileged for their benefit.	3. Is the “right thing to do.” Three centuries of discrimination requires compensatory justice.
4. Disadvantages mainstream groups for injustices they did not cause and with which they do not agree.	

Questions

1. Which side of the arguments do you accept as most reasonable and realistic? Explain.
2. State why the “Opponents” reasoning has validity.
3. State why the “Advocates” reasoning has validity.
4. Does a level playing field exist in the society in which you live? Explain.

They want a federal judge to award damages to 30,000 white and Asian students who may have been illegally denied admission to make way for other minority students.”<sup>110</sup>

UCLA Law Professor Richard H. Sander argues that affirmative-action programs are harmful for African-American law school students because high attrition rates resulting from admitting students who fail to do the work will, in turn, turn away African-American students from entering. Sander’s opponents disagree with his methods and analysis. The debate over just and unfair affirmative action policies and procedures, especially in university admittance policies, continues to evolve.



## 7.5 SEXUAL HARASSMENT IN THE WORKPLACE

*Sexual harassment* was not a specific violation of federal law before 1981. It now may be difficult to imagine flagrant acts of sexual violation against women, but as recently as 20 years ago, when women worked in mines, they, like their male counterparts, were stripped and soaked in axle grease in a primitive hazing ritual, and then, unlike the male employees, the women were tied to wooden supports in spread-eagle positions.<sup>111</sup> The Senate hearings on sexual harassment charges against Supreme Court nominee Clarence Thomas awakened public and corporate concern about sexual harassment in society and the workplace. In addition, the overt sexual harassment of female U.S. Navy professionals also has brought attention to this issue. Although sexual harassment can be and is committed by both men and women, it is more often women who are the unwilling victims.

Sexual harassment remains among the most prominent civil rights issues in the workplace. There were 15,836 sexual harassment charges filed with the EEOC or state agencies in 2000 with \$54.6 million paid in monetary benefits (not including monetary benefits obtained through litigation). TWA agreed to pay \$2.6 million to settle a sexual harassment suit filed in 1998. The suit is one of the largest in New York State. The company will pay \$1.5 million to nine women who worked in ground traffic control, passenger service, and maintenance. The *New York Times* reported that three women “accused three high-level managers of egregious sexual harassment that included groping and verbal abuse.” Lawyers for the women said that the airline did nothing about repeated complaints taken to different levels of management before the suit was filed.<sup>112</sup> More recently, a meta-analysis on sexual harassment showed an organization’s climate was a factor in sexual harassment incidences. Also victims experienced posttraumatic stress disorder, loss of work, decreased organizational commitment, poor job satisfaction, and problems with physical and mental health.<sup>113</sup>

### What Is Sexual Harassment?

The Supreme Court ruled in 1986 that sexual harassment is illegal under Title VII of the 1964 Civil Rights Act and that when a “hostile environment” is created through sexual harassment in the workplace, thereby interfering with an employee’s performance, the law is violated, regardless of whether economic harm is done or whether demands for sexual favors in exchange for raises, promotions, bonuses, and other employment-related opportunities are granted.<sup>114</sup>

Under Title VII, the EEOC guidelines (1980) define sexual harassment as follows:

Unwelcome sexual advances, requests for sexual favors, and other verbal or physical conduct of a sexual nature constitute sexual harassment when (1) submission to such conduct is made either explicitly or implicitly a term or condition of an individual’s employment, (2) submission to or rejection of such conduct by an individual is used as the basis for employment decisions affecting such an individual, or (3) such conduct has the purpose or effect of unreasonably interfering with an individual’s work performance or creating an intimidating, hostile, or offensive working environment.



The courts have defined sexual harassment as conduct ranging from blatant grabbing and touching to more subtle hints and suggestions about sex. Forms of sexual harassment include the following:<sup>115</sup>

- Unwelcome sexual advances
- Coercion
- Favoritism
- Indirect harassment
- Physical conduct
- Visual harassment (For example, courts have ruled that sexual harassment was committed when graffiti were written on men's bathroom walls about a female employee and when pornographic pictures were displayed in the workplace.)

More women are speaking out under the protection of Title VII of the amended Civil Rights Act, which is discussed later in this chapter. Sexual harassment continues to be reported across industries, including outstanding companies such as Wal-Mart. Moreover, men's sexual harassment charges increased 15.4% to the EEOC in 2006, compared to 14.3% in 2005.<sup>116</sup> These statistics do not show whether the alleged harassers of men were also men, although they generally are. Diversity training programs are now offered in many larger reputable U.S. firms.

## Who Is Liable?

The EEOC guidelines place absolute liability on employers for actions and violations of the law by their managers and supervisors, whether or not the conduct was known, authorized, or forbidden by the employer. Employers also are liable for coworkers' conduct if the employer knew, or should have known, of the actions in question, unless the employer shows, after learning of the problem, that the company took immediate and appropriate action to correct the situation. Employers may be liable for harassment of nonemployees under the same conditions as those stated for coworkers.<sup>117</sup>

Moreover, under EEOC guidelines employers are responsible for establishing programs (and standards) that develop, train, and inform employees about sanctions and procedures for dealing with sexual harassment complaints (see Figure 7.5). It is in the employer's economic and moral interest to institute such programs, because courts mitigate damages against companies that have harassment prevention and training programs. Some of the leaders in establishing sexual harassment policies and programs are Nynex, AT&T, DuPont, Corning, and Honeywell, to mention only a few.

## Tangible Employment Action and Vicarious Liability

A currently prominent feature of harassment cases is the concept of "tangible employment action," which Supreme Court Justice Anthony Kennedy described as "hiring, firing, failing to promote, reassignment with significantly different responsibilities or a decision causing a significant change in benefits."<sup>118</sup> An employer's defense against claims of harassment has been

Figure 7.5

### Sample Corporate Sexual Harassment Policy

1. Sexual harassment is a violation of the corporation's EEO policy. Abuse of anyone through sexist slurs or other objectionable conduct is offensive behavior.
2. Management must ensure that a credible program exists for handling sexual harassment problems. If complaints are filed, they should receive prompt consideration without fear of negative consequences.
3. When a supervisor is made aware of an allegation of sexual harassment, the following guidelines should be considered:
  - a. Obtain information about the allegation through discussion with the complainant. Ask for and document facts about what was said, what was done, when and where it occurred, and what the complainant believes was the inappropriate behavior. In addition, find out if any other individuals observed the incident, or similar incidents, to the complainant's knowledge. This is an initial step. In no case does the supervisor handle the complaint process alone.
  - b. If the complaint is from an hourly employee, a request for union representation at any point must be handled as described in the labor agreement.
  - c. The immediate supervisor or the department head and the personnel department must be notified immediately. When a complaint is raised by, or concerns, an hourly employee, the local labor relations representative is to be advised. When a complaint is raised by or concerns a salaried employee, the personnel director is to be advised.
4. The personnel department must conduct a complete investigation of the complaint for hourly and salaried employees. The investigation is to be handled in a professional and confidential manner.

**SOURCE:** Based on the General Motors corporate policy on sexual harassment.

created in cases in which a hostile environment was evident but no tangible employment action occurred. In the Supreme Court decision in the case *Burlington Industries v. Ellerth*:

Kimberly Ellerth's harasser threatened to take steps against her if she didn't comply with his wishes. Since he never carried out the threat, Ellerth's employment status was not negatively affected. However, her harassment was severe and pervasive, and Burlington was held liable for that instead.<sup>119</sup>

Severe and pervasive harassment that has no tangible employment action characterized another case, *Faragher v. City of Boca Raton*. In this case, it was determined that lifeguard Beth Faragher had been repeatedly harassed by two male supervisors for several years. She complained to other beach supervisors, but to no avail. Attorneys for the city argued that she had not complained to authorities at a high enough level. This defense laid the foundation for another key concept the Court stressed: "vicarious liability."<sup>120</sup>

Employers, under this concept, could be liable for harassment if it is committed by anyone present in the workplace and if it is brought to the attention of any manager or supervisor. Employers are liable for harassment by anyone who is present in the workplace (coworkers, customers, vendors), if the employers know or should have known about the harassment. Moreover, employers are liable for harassment by all supervisors, whether the employer knew about the harassment or not. This represents a significant change in sexual harassment liability.

**Employer Guidelines with Extended Liability Rulings** Employers should:

- Exercise reasonable care to prevent and correct for any harassment. There should be an anti-harassment policy and a complaint procedure present, made known to every employee, readily available, and used in training. The EEOC enforcement guidelines provide an excellent source of training materials.
- Quickly and effectively address all harassment complaints.<sup>121</sup>

**Individual Guidelines** Although sexual harassment often occurs as part of a power issue (i.e., people in more-powerful positions exert pressure over people in less-powerful posts), a frequent observation is that men and women tend to see sexual harassment differently. This certainly does not justify legally or morally unwelcome sexual advances. It does suggest, however, that employers need to provide adequate education, training, and role-playing between the sexes so that gender differences in perceptions and feelings on what constitutes sexual harassment can be understood. Some practical guidelines that employees (men, in this instance) can use to check their motives and behavior regarding sexual harassment include the following:<sup>122</sup>

- If you are unsure whether you have offended a woman, ask her. If you did offend her, apologize, and don't do it again.
- Talk over your behavior with noninvolved women and with men you can trust not to make a mockery of your concerns.
- Ask yourself how you would feel if a man behaved toward your daughter the way you feel you may be behaving toward women.
- Ask yourself also if you would act this way if the shoe were on the other foot, if the woman were your boss or if she were physically stronger or more powerful than you.
- Most of all, don't interpret a woman's silence as consent. Silence is, at least, a "red light." Through silence, a woman may be trying to send you a signal of discomfort. Be very certain that your comments or behaviors are welcome, and if they are not, stop them.

## **Sexual Harassment and Foreign Firms in the United States**

Two foreign companies operating in the United States have reacted differently to sexual harassment charges; this is a perilous area where the law and societal norms are rapidly changing. These companies' reactions have exposed them to increased liability. One of the firms, Astra, a Swedish

pharmaceutical firm, fired its CEO of the U.S. subsidiary and two other top managers. The other company, Mitsubishi, has denied all charges, has maintained that EEOC is wrong, and has mounted a full-scale public relations campaign to discredit complainers. Both companies lacked one of the most basic requirements consultants recommend: a clear and strongly written policy on sexual harassment.<sup>123</sup>

Companies have the obligation of training and supporting their employees who work and conduct business internationally on harassment and discrimination laws. “When in Rome, do as the Romans do” does not mean do nothing, act immorally, or act from your own intuition as an employee representing your company. As Figure 7.6 illustrates, many countries have specific laws on employment discrimination and sexual harassment. Some are not the same as those in the U.S. For example, Venezuela, as of January 1, 1999, has a new employment discrimination statute that prohibits sexual harassment and punishes this crime by a prison term from 3 to 12 months. The offender must also pay the victim twice the amount of economic damage in regard to lack of access to positions, promotions, or job performance that resulted from the sexual harassment.<sup>124</sup> Louise Simms, the MBA student from the opening story in Chapter 3, may now have more information to research before approaching her employer and potential client.

Figure 7.6

### Survey of Harassment and Its Crimination Law

Jurisdiction	Prohibitions on Employment Discrimination	Prohibitions on Sexual Harassment	Legal Basis
Argentina	Yes	Yes, by judicial ruling	Section 16, Argentine Constitution
Australia	Yes	Yes	Race, Sex, and Disability Acts
Belgium	Yes	Yes	Article 10, Belgian Constitution; Royal Decree of September 19, 1997
Brazil	Yes	No	Article 5, Brazilian Constitution; Section 461, Brazilian Labor Code
Canada	Yes	Yes	Human rights laws of each province
Chile	Yes	Yes	Article 19, Constitution; Article 2, Labor Code
Colombia	Yes	No	Article 53, Constitution; Article 10, Labor Code

(continued)

Figure 7.6

Survey of Harassment and Its Crimination Law (continued)

Jurisdiction	Prohibitions on Employment Discrimination	Prohibitions on Sexual Harassment	Legal Basis
Czech Republic	Yes, by judicial decision	No	Decision No. 13/94, Constitutional Court
Egypt	Yes	No, except by extension of Civil Code	Article 40, Constitution
France	No	Yes	Article L 122-46, French Labor Code; Article 27, Law of December 31, 1992
Germany	No	Yes	Section 2, Article 31, Constitution; Disability Act; Employee Protection Act
Hong Kong	Yes	Yes	Sex Discrimination Ordinance; Disability Discrimination Ordinance
Hungary	Yes	No	Article 5, Hungarian Labor Code
Ireland	Yes	Yes	Employment Equality Act
Italy	Yes	Yes, by judicial decision	Law No. 125 of April 10, 1991
Japan	Yes	Yes	Equal Employment Opportunity Act
Mexico	No	Yes	Section 153, Mexican Penal Code
Netherlands	Yes	Yes	Article 3, Dutch Labor Conditions Act; Article 7, Dutch Civil Code
People's Republic of China	Yes	No	Article 12, Labor Law of the PRC (1995)
Philippines	No	Yes	Republic Act 7877 (1995)

Figure 7.6

**Survey of Harassment and Its Crimination Law (*continued*)**

<b>Jurisdiction</b>	<b>Prohibitions on Employment Discrimination</b>	<b>Prohibitions on Sexual Harassment</b>	<b>Legal Basis</b>
Poland	Yes	No	Articles 32 and 33, Constitution; Labor Code
Republic of South Africa	Yes	No	Act No. 66, South African Labor Reform Act of 1995
Russia	Yes	No	Russian Labor Law of 1995
Singapore	Yes; age only	No	Retirement Act
Spain	Yes	Yes	Articles 9, 14, and 35, Spanish Constitution; Section 34.3.95 of Spanish Employment Act
Sweden	Yes	Yes	The Act on Equal Opportunities at Work
Switzerland	No	Yes	Article 3, Law on Equal Treatment of Women and Men
Taiwan	No	Yes	Article 83, ROC Social Order Maintenance Act
Thailand	Yes	Yes	Constitution; Labor Protection Act
Ukraine	Yes	No	Article 42, Labor Code of the Ukraine
United Kingdom	Yes	Yes	Sex, Race, and Disability Discrimination Laws
Venezuela	No	Yes	Law on Violence Against Women and Family

**SOURCE:** Adapted with permission from Gerald Maatman, Jr. "Harassment, discrimination laws go global." *National Underwriter*, September 11, 2000, 3.

## 7.6 WHISTLE-BLOWING VERSUS ORGANIZATIONAL LOYALTY

The decision to become a whistle-blower frequently requires breaking with the very group that we have viewed as critical to our financial success, if not our very survival. The decision entails destabilizing one's life and placing

all the essential underpinnings of our financial security—and the security of those who depend on us—at total risk. It is easy to understand that such a decision is accompanied by a good deal of anxiety and stress.<sup>125</sup>

Among all the rights discussed in this chapter, one of the most valued by a U.S. citizen is freedom of speech. But how far does this right extend into the corporation, especially if an employee observes an employer committing an illegal or immoral activity that could harm others? What are the obligations and limits of employee loyalty to the employer? Under what, if any, circumstances should employees blow the whistle on their supervisors, managers, or firms?

Whistle-blowing is “the attempt of an employee or former employee of an organization to disclose what he or she believes to be wrongdoing in or by the organization.”<sup>126</sup> Whistle-blowing can be internal (reported to an executive in the organization), external (reported to external public interest groups, the media, or enforcement agencies), personal (harm reportedly done only to the whistle-blower), and impersonal (harm observed as done to another).<sup>127</sup> Whistle-blowing goes against strong U.S. cultural norms of showing loyalty toward an employer and colleagues and avoiding the “snitch” label. However, strong cultural norms regarding fairness, justice, a sense of duty, and obedience to the law and to one’s conscience also exist. A moral dilemma can occur when a loyal employee observes the employer committing or assisting in an illegal or immoral act and must decide what to do. The whistle-blower may not only lose his or her job but may also experience negative and damaging repercussions in his or her profession, marriage, and family life. Dr. Jeffrey Wigand, head of research at Brown and Williamson Tobacco Company from 1989 to 1993, testified that this company knew and controlled nicotine levels in its products. His testimony, along with that of others, helped the government initially win a substantial lawsuit against the tobacco industry. As the film *The Insider* accurately documented, Wigand paid an enormous personal price as a witness.<sup>128</sup> Karen Silkwood, now a classic example of one person’s bold attempt to share inside information, may have been murdered for blowing the whistle on the Kerr-McGee plutonium company:

Karen Silkwood was killed on November 12, 1974, at 28 years of age while driving to meet a reporter from the *New York Times* with documentation about plutonium fuel rod tampering at the Kerr-McGee uranium and plutonium plants in Cimarron, Oklahoma.<sup>129</sup>

The second edition of Richard Rashke’s book, *The Killing of Karen Silkwood* (Cornell University Press, 2000), recounts the story in detail.

Not all whistle-blowers undergo such traumatic fates as the two examples offered here. Michael Haley, a federal bank examiner, won \$755,533 in backpay, future loss of income, and compensatory damages under the federal whistle-blower statute and another amended federal statute. He had worked as a bank examiner for the Office of Thrift Supervision (OTS), starting in 1977. He inspected OTS-regulated banks, evaluating the soundness of their operations. He was terminated after he reported violations in federal banking laws and regulations regarding a forced merger.<sup>130</sup>

Under what conditions is whistle-blowing morally justified? DeGeorge<sup>131</sup> discusses five conditions:

1. When the firm, through a product or policy, will commit serious and considerable harm to the public (as consumers or bystanders), the employee should report the firm.
2. When the employee identifies a serious threat of harm, he or she should report it and state his or her moral concern.
3. When the employee's immediate supervisor does not act, the employee should exhaust the internal procedures and chain of command to the board of directors.
4. The employee must have documented evidence that is convincing to a reasonable, impartial observer that his or her view of the situation is accurate and evidence that the firm's practice, product, or policy seriously threatens and puts in danger the public or product user.
5. The employee must have valid reasons to believe that revealing the wrongdoing to the public will result in the changes necessary to remedy the situation. The chance of succeeding must be equal to the risk and danger the employee takes to blow the whistle.

The risks to whistle-blowers can range from outright termination to more subtle pressures, such as strong and hidden criticisms, undesirable and burdensome work assignments, lost perks, and exclusion from communication loops and social invitations.<sup>132</sup> Although 21 states have laws protecting corporate and governmental whistle-blowers from reprisal, experience shows that the government's actual protection to whistle-blowers, even if after resigning or being fired they are reinstated with back pay and compensation for physical suffering, is weak because of the many subtle forms of retaliation, such as those just listed.<sup>133</sup>

## When Whistle-Blowers Should Not Be Protected

The most obvious condition under which whistle-blowers should not be protected is when their accusations are false and their motivation is not justifiable or accurate.

The following instances show when whistle-blowers should not have freedom of speech against their employers:

- When divulging information about legal and ethical plans, practices, operations, inventions, and other matters that should remain confidential and that are necessary for the organization to perform its work efficiently
- When an employee's personal accusations or slurs are irrelevant to questions about policies and practices that appear illegal or irresponsible
- When an employee's accusations do not show a conviction that a wrongdoing is being committed and when such accusations disrupt or damage the organization's morale
- When employees complain against a manager's competence to make daily work decisions that are irrelevant to the legality, morality, or responsibility of management actions
- When employees object to their discharge, transfer, or demotion if management can show that unsatisfactory performance or violation of a code of conduct was the reason for the decision<sup>134</sup>



## Factors to Consider before Blowing the Whistle

Whistle-blowing is a serious action with real consequences. It often involves a decision to be made among conflicting moral, legal, economic, personal, family, and career demands and choices. No single answer may appear. A stakeholder analysis and questions can help the potential whistle-blower identify the groups and individuals, stakes, priorities, and trade-offs when deciding among different strategies and courses of action.

The following 12 guidelines offer factors<sup>135</sup> that a person should consider when deciding whether to blow the whistle on an employer:

1. Make sure the situation warrants whistle-blowing. If serious trade secrets or confidential company property will be exposed, know the harm and calculated risks.
2. Examine your motives.
3. Verify and document your information. Can your information stand up in a hearing and in court?
4. Determine the type of wrongdoing and to whom it should be reported. Knowing this will assist in gathering the type of evidence to obtain.
5. State your allegations specifically and appropriately. Obtain and state the type of data that will substantiate your claim.
6. Stay with the facts. This minimizes retaliation and avoids irrelevant mudslinging, name-calling, and stereotyping.
7. Decide whether to report to internal contacts or external contacts. Select the internal channel first if that route has proven effective and less damaging to whistle-blowers. Otherwise, select the appropriate external contacts.
8. Decide whether to be open or anonymous. Should you choose to remain anonymous, document the wrongdoing and anticipate what you will do if your identity is revealed.
9. Decide whether current or alumni whistle-blowing is the best alternative. Should you blow the whistle while you are an employee or resign first? Resigning should not be an automatic option. If the wrongdoing affects others, your decision is not only a personal one, but you are also fulfilling moral obligations beyond your own welfare.
10. Follow proper guidelines in reporting the wrongdoing. Check forms, meeting deadlines, and other technicalities.
11. Consult a lawyer at every step of the way.
12. Anticipate and document retaliation. This assists your effectiveness with courts and regulatory agencies.

## Managerial Steps to Prevent External Whistle-Blowing

Managers have a responsibility to listen to and respond to their employees, especially regarding the observations of and reporting of illegal and immoral acts. Chapter 5 discussed mechanisms such as “ethics offices,” ombudsperson programs, and peer review programs. These are part of a corporation’s responsibility to provide due process for employees to report personal grievances, to obtain effective and just resolution of them, and to report the wrongdoings of others, including the employers.

Four straightforward and simple steps management can take to prevent external whistle-blowing are:<sup>136</sup>

1. Develop effective internal grievance procedures and processes that employees can use to report wrongdoings.
2. Reward people for using these channels.
3. Appoint senior executives and others whose primary responsibilities are to investigate and report wrongdoing.
4. Assess large fines for illegal actions. Include executives and professionals who file false or illegal reports, who knowingly market dangerous products, or who offer bribes or take kickbacks.

Preventing, reporting, and effectively and fairly correcting illegal and immoral actions, policies, and procedures are the responsibilities of employers and employees. Management cannot expect employees to be loyal to a company that promotes or allows wrongdoing to its stakeholders. Whistle-blowing should be a last resort. A more active goal is to hire, train, and promote morally and legally sensitive and responsive managers who communicate with and work for the welfare of all stakeholders.

## CHAPTER SUMMARY

The demographics of the workforce at the beginning of the 21st century continue to change. These changes include the aging of employees, the “shrinking” of the workforce, an increasing number of women and minority entrants, the demand for work-life balance from singles and dual-career families, the gap in educational levels, and a greater demand for the skills of disabled workers. The changes in the composition of the workforce signal changes in work-related values and motivations. Corporations and managers can expect moral tensions to rise regarding issues such as age discrimination, health care needs, conflicting communication, generational differences, and requests for more balanced and flexible work schedules. “One size fits all” management techniques do not work.

The social and psychological contract between corporations and employees is also changing. The original employment-at-will doctrine serves as the basis for employment between employer and employee; however, over the years, this doctrine has been complemented by the doctrine of implied employee rights. Most firms, large and small, use a mix of the two doctrines. Two underlying concepts of employee rights are balance and governmental rights.

The nature of legal and moral relationships between employers and employees is also changing. Employers rely on federal and state laws to guide their employee policies and procedures. However, many employers implement benefits and policies aimed at motivating and supporting employees’ well being. Work-life resources and insurance coverage for employees’ same-sex partners are such examples.

Recent court decisions have supported racial affirmative action practices at the university admittance level. Although EEOC policies and affirmative action practices remain a part of federal law, some states are showing less acceptance of these laws and procedures. Current and future issues related to

sexual harassment and reverse discrimination will continue to shape legal and moral guidelines for corporations. Conflicts regarding due process, privacy, safety, drug testing, sexual harassment, technology monitoring, and other workplace topics will continue to be resolved through court cases and legislation; their resolution will influence corporate policies in the future.

Sexual harassment laws and guidelines for employers and employees and the moral dilemma of organizational loyalty versus personal ethics will always be important issues. The justification for whistle-blowing and guidelines for potential whistle-blowers must be considered by employees before blowing the whistle and by corporations to prevent external whistle-blowing.

## QUESTIONS

1. Identify two major trends in the changing demographics of the workforce. Include a trend that you as a student or employee could be or are now affected by.
2. Identify moral tensions and/or conflicts that could lead to illegal and/or unethical behavior associated with the changes you gave in Question 1.
3. What are three major factors an employer should consider to avoid arbitrarily terminating an employee? What steps would you take if you were terminated by an employer who arbitrarily fired you?
4. What problems do you see occurring when employees date in a company? What additions or changes would you make to the tips and suggestions offered on dating in the chapter?
5. What does the term legal and moral entitlement mean to you as an employee or future employee? Give an example. Do you agree that employees have legal and moral entitlements in the workplace? Explain.
6. Do you believe dating should be permitted among employees in the workplace without formal policies setting boundaries and rules? Why or why not?
7. Do you believe managers and company officers should date lower level employees with less power and status? Why could this situation present ethical dilemmas?
8. What are some changes that have occurred as a result of the Civil Rights Act of 1991?
9. Do you believe there is now an "equal playing field" regarding access to educational institutions, jobs, and other employment opportunities for all individuals and groups in the United States? Explain. Do you believe women should still be a protected group under Title VII of the Civil Rights Act? Explain. Do you believe minorities of different races in the U.S. other than Caucasian should still be protected? If so, which group(s)? If not, explain why not.
10. What are some arguments for and against "reverse discrimination"? Is the "playing field" in U.S. corporations more level now?

11. Describe criteria used to determine whether verbal or physical actions constitute sexual harassment. What are some specific types of sexual harassment? Have you been sexually harassed in a work setting? Can you describe what happened and the outcome?
12. What should employees expect from their employers and their companies now in terms of rights and obligations? Explain. Is loyalty to an employer a “dead” or “dying” concept now? Why or why not?
13. Do you believe whistle-blowing is justifiable in corporations? Would, or could, you blow the whistle? Under what circumstances would you be compelled to blow the whistle as an employee in an organization? Offer an example.
14. Should corporate managers prevent whistle-blowing? Why or why not? Explain.
15. How can employers prevent whistle-blowing?

## EXERCISES

1. Argue the pros and cons of eliminating standards such as test scores, grade point averages, and other objective criteria for admitting minorities and members of protected groups to universities and colleges. Do you believe such objective criteria should be eliminated by university and college admissions committees? Explain.
2. Select an employee right in the workplace from the chapter. Give an example, based on your own outside reading or experience, of a situation involving this right. Was it violated? How? What was the outcome? What should the outcome have been? Why?
3. Identify an example from your own experience, or that of someone you know, of discrimination or sexual harassment. Did this experience influence your view of affirmative action or employee protection programs? If so, how?
4. Write a paragraph describing a situation from your experience in which you felt justified that you had cause to blow the whistle. Did you? Why or why not? Under what circumstances do you feel whistle-blowing is justified?
5. Think of three people you know from the different generations discussed in the chapter. From these people, who is and is not satisfied with their work and jobs? Explain why they are or are not satisfied. Refer back to the generational differences and values in the chapter. To what extent did “generational differences” contribute in your analysis of the individuals’ work satisfaction? To what extent did “ethical reasons” affect their work satisfaction? Explain.
6. Create a “for” and “against” set of arguments regarding the “employment-at-will” doctrine in the present economic and demographic environment. After you make a complete set of arguments, which position do you support? Did your views change after this exercise? Why or why not?

## REAL-TIME ETHICAL DILEMMA



## What's Going on Here?

Bill Smith and Lana Kane seemed to have had some “bad chemistry” the day they met. Bill, 23, a recent graduate and now working on his MBA, has been with the Marketing Group for a year. He is eager to excel, thrives on instant (especially positive) feedback, and is accustomed to participative, entrepreneurial work relationships. Upper-level management has been impressed with his work and has given him “free reign” on most assignments, since the Group had been without a director for the past year. Lana, 51, has been with the company for nine years and has just been assigned to head up the Marketing Group. Lana is accustomed to a more structured, orderly approach and also takes her seniority seriously. Bill was preparing a presentation on a new promising product launch for the company’s CEO and officers when he found an e-mail from Lana asking to review and approve his presentation before he submits it to Ralph, the CEO.

Lana’s e-mail was critical of several of Bill’s ideas, and she asked to meet with him. At their one-on-one meeting the following afternoon in Lana’s office, they immediately started clashing. Lana politely but straightforwardly read her responses to Bill’s e-mail, and Bill couldn’t remain silent. He challenged her on

every point, refusing to accept her logic. Lana grew tense and finally lashed out at Bill saying, “Can’t you be more open to different perspectives? My role is to offer criticism to improve our efforts, not only to always give praise.” Bill was frustrated and hurt that Lana couldn’t see the same talent in him that upper management saw. “Why is she so stubborn and controlling?” he thought as she folded up the paper with her comments about his presentation. Nervously pondering the situation before leaving her office, he thought, “Maybe I should talk to Ralph about her. If I have to work with this style, I should pack my bags today.” At the same time, when Lana looked at Bill’s expressions, she thought, “I’m not sure this guy ‘gets it.’ He’s bright but too spoiled, and not tough skinned enough to take helpful criticism. I wonder if I should talk to HR [human resources] about him?”

## Questions

1. What are the problems in this situation?
2. What potential “ethical” dilemma or issue could arise from this situation?
3. What perspective(s) in this chapter could help diagnose this evolving issue?
4. What should be done to prevent an issue from erupting into a conflict and between whom?

## Case 19

### Wal-Mart: Ongoing Challenges with Gender Discrimination

The Civil Rights Act of 1964 forbids gender-based discrimination in the employment arena. Section 703 of this act specifies that:

- “It shall be an unlawful employment practice for an employer to fail or refuse to hire or to discharge any individual, or otherwise to discriminate against any individual with respect to his compensation, terms, conditions, or privileges of employment, because of such individual’s race, color, religion, sex, or national origin.”
- “It shall be an unlawful employment practice for an employer to limit, segregate, or classify his employees in any way which would deprive or tend to deprive any individual of employment opportunities or otherwise adversely affect his status as an employee, because of such individual’s race, color, religion, sex, or national origin.”

In *Dukes v. Wal-Mart Stores, Inc.*, Betty Dukes, the lead plaintiff along with five other plaintiffs and the class that they represent charged that “Wal-Mart discriminates against its female employees by advancing male employees more quickly than female employees, by denying female employees equal job assignments, promotions, training and compensation, and by retaliating against those who oppose its unlawful practices.” In addition, the plaintiffs sought to end Wal-Mart’s discriminatory practices, to receive relief for the class, and to secure punitive damages. *Dukes v. Wal-Mart Stores, Inc.* also alleged that Wal-Mart’s underlying culture and policies contributed to the discrimination that the plaintiffs experienced.

“The theories pursued in the *Dukes* litigation involve what are known as

‘glass ceiling/sticky floor’ allegations of employment discrimination that female employees are relegated to low-paying positions and are unable to be promoted into better paying and higher-level managerial jobs.” According to data supplied by statistical consultant Richard Drogin on behalf of the plaintiffs, Wal-Mart had an established pattern of discrimination against women. In his statistical report, Drogin concluded that: “Women employees at Wal-Mart are concentrated in the lower paying jobs, are paid less than men in the same job, and are less likely to advance to management positions than men. These gender patterns persist even though women have more seniority, have lower turnover rates, and have higher performance ratings in most jobs. The shortfall in female earnings, pay rates, and promotion rates has a high degree of statistical significance.”

Wal-Mart’s expert witness, Joan Haworth, an economist who had provided testimony in more than five dozen employment cases, reached different conclusions regarding pay disparity at the giant retailer. She claimed that “Drogin’s analyses did not adequately take into account crucial factors, like the number of hours worked and whether they included night-shift work, which pays more. But her overarching criticism was that his approach amounted to pretending that a single person was making all promotion and pay decisions throughout Wal-Mart nationwide, when, according to depositions, most pay determinations were made at the store manager level or, in the case of certain specialty department employees, at the district manager level.” She concluded that “more than 90% of class members worked at stores where women were

statistically no worse off than men. Wal-Mart's argument, then, was that if a class action must be filed, it should be brought against the specific stores with disparities favoring men."

**Class Action or Not?** Perhaps the most contentious issue in the *Dukes v. Wal-Mart Stores, Inc.* case has been whether or not a class action is warranted. A class action filing is affected by Rule 23 of the Federal Rules of Civil Procedure, which prescribes the conditions under which class action suits may be brought to Federal courts. Rule 23(a) outlines the prerequisites for a class action. They are: "(1) the class is so numerous that joinder of all members is impracticable; (2) there are questions of law or fact common to the class; (3) the claims or defenses of the representative parties are typical of the claims or defenses of the class; and (4) the representative parties will fairly and adequately protect the interests of the class."

Wal-Mart challenged the legal validity of a class action in the case, arguing, in a September 24, 2003 hearing before U.S. District Judge Martin Jenkins, that the lawsuit should be broken into separate class actions against each of the 3,473 stores across the United States because decisions about pay and promotions are largely made at the store level. On June 22, 2004, Judge Jenkins ruled that six current and former Wal-Mart employees from California may represent all female employees of Wal-Mart who worked at its U.S. stores anytime since December 26, 1998. In his findings, Judge Jenkins said that the evidence presented by the plaintiffs "raises an inference that Wal-Mart engages in discriminatory practices in compensation and promotion that affect all plaintiffs in a common manner."

Judge Jenkins' ruling is potentially momentous because "[c]lass-action litigation is unlike a single plaintiff lawsuit in that the stakes are enormous and the exposure to a corporation increases geometrically if the plaintiffs are successful.

The holy grail of class-action litigation for both sides is the class certification decision. . . . Practically speaking, victory or defeat in the class certification process casts the die for a corporation's exit strategy from class action litigation."

### **Enter the United States Court of Appeals for the Ninth Circuit**

On appeal to the Ninth Circuit, located in San Francisco, California, Wal-Mart claimed that the proposed class failed to meet the commonality prerequisite of Rule 23(a)(2) since local store managers had autonomy in making salary and promotion decisions. However, "the plaintiffs said this hands-off approach itself constituted the common policy that impacted class members—arguing it fostered discrimination by allowing individual managers to make excessively subjective decisions based on gender stereotypes." In support of this position, plaintiffs presented evidence from an expert witness, sociologist William Bielby, who based his testimony on so-called "social framework analysis." Bielby testified that "a strong and widely shared organizational culture promotes uniformity of practices throughout an organization," and that such a culture "could be inferred from such factors as Wal-Mart's emphasis on the company's founder and its history, a mission statement defined by core values, [and] frequent communication about the culture to employees." Allan King, an interested observer who has a doctorate in labor economics and a law degree, says, "There is no such thing as social framework analysis. . . . But it will be a challenge for defendants to persuade the court that what they [i.e., plaintiffs' expert witnesses] regard as a methodology is not." Ultimately, the Ninth Circuit used Bielby's testimony to support its finding that commonality had been demonstrated for the class. The court wrote, "Evidence of Wal-Mart's subjective decision-making policy raises an inference of discrimination and provides further evidence of a common practice."

On February 6, 2007, the United States Court of Appeals for the Ninth Circuit affirmed, on a 2–1 vote, U.S. District Court Judge Martin Jenkins’ decision to certify a class that had grown to approximately two million women in the lawsuit against Wal-Mart. The class includes the more than two million women who have worked at any of the company’s more than 4,000 retail stores nationwide since December 26, 1998. Writing for the majority, Judge Harry Pregerson “deferred to the district court’s ‘broad discretion’ to certify and did not amend any of its findings.” Most of the Ninth Circuit Court’s opinion addressed the commonality prerequisite of Rule 23(a)(2). The Ninth Circuit’s opinion said that “Plaintiffs demonstrated that Wal-Mart had a corporate policy of discrimination (because the policy was corporate-wide, it would be in effect at every Wal-Mart store and thus would be common to every female Wal-Mart employee).” However, in a strongly worded dissent, Judge Andrew J. Kleinfeld said the appellate decision “poses a considerable risk of enriching undeserving class members and counsel, but depriving thousands of women actually injured by sex discrimination their just due.”

In response to the Ninth Circuit’s ruling, Theodore J. Boutros Jr., an attorney representing Wal-Mart, said, “We recognize this is another step in what is going to be a long process. It’s a technical legal ruling that only certifies the lawsuit as a class action, but does not address its merits.” Boutros also expressed the belief that Wal-Mart has a strong argument for obtaining further review from either the full Ninth Circuit Court or the United States Supreme Court, “because the majority rule conflicts with many Supreme Court decisions as well as many recent decisions from other appellate courts around the country that ‘have rejected precisely the direction taken by the [Ninth Circuit] court.’” However, Brad Seligman, representing the Wal-Mart plaintiffs, said, “The appellate court is now the second court to rule on the class certification

issue and ‘it’s clear Wal-Mart is going to have to face the music and justify its practices, and we are very optimistic this case will ultimately be returned to trial.’” In fact, Wal-Mart has asked the full Court of Appeals for the Ninth Circuit to reconsider the 2–1 approval of the class. Should the appeal to the full Appellate Court fail, Wal-Mart will probably seek review by the United States Supreme Court.

### **Potential Implications of *Dukes v. Wal-Mart Stores, Inc.***

Observers say the 2–1 decision by the Ninth Circuit Court of Appeals does not break any new legal ground even though it could end up costing Wal-Mart billions of dollars. Rather, the primary significance of the ruling is the unprecedented size of the class action. Anthony J. Oncidi, an attorney with Proskauer Rose L.L.P. in Los Angeles, said Judge Kleinfeld’s strong dissent in the 2–1 ruling suggests that other Ninth Circuit judges may also believe that the 2–1 majority ruling is not really appropriate, which could lead to a re-examination by the full appellate court. Ultimately, the Supreme Court “may respond to business community demands that it ‘tighten up class certification’ in the same way it tightened rules on punitive damages.”

Although *Dukes v. Wal-Mart, Inc.* may not break any new legal ground, employers nonetheless may want to rethink their practices. As Susie Gibbons, an attorney with Poyner & Spruill L.L.P. in Raleigh, N.C., says, “The huge potential liability of this case represents an expansion of the class action vehicle as a weapon of attack against employers, and it should cause all companies of any size to review their own hiring and promotional practices. . . . If I were a risk manager at a company, I would want to analyze this case to look at what the vulnerabilities were that ended up causing this problem for Wal-Mart.” Writing in *Fortune* magazine, Roger Parloff and Susan Kaufman point out that although racial or gender quotas and preferences are illegal, “they will obviously be tempting to employers



who want to avoid being hit with class-action employment discrimination lawsuits. For there is only one sure-fire way to inoculate oneself against such suits, and that is to have workforce numbers that look good even when analyzed by a plaintiffs' expert. And the cheapest and fastest way to get those is to use quotas or preferences."

Mary Swanton, writing in *Inside-Counsel*, says that "employers can use the findings in *Dukes* to assess their vulnerabilities. For example, companies could test how their corporate culture would stand up to a sociologist's analysis. They also could look at how their decision-making processes can be made more objective and whether they have processes in place to ensure their managers implement non-discrimination policies." Meg Campbell, with Ogletree, Deakins, Nash, Smoak & Stewart, says, "If they [employers] take the lesson of this court's analysis and look at what they are doing and how they can do it better, they'll put themselves in the best defensive posture in the event of litigation."

Roger Parloff and Susan Kaufman also remark, "The Wal-Mart rulings could end up representing a high-water mark. . . . The underlying legal battles seem destined for the [United States] Supreme Court. The urgent question is whether the current [Supreme] Court with its staunchly conservative five-justice majority, sharp aversion to race-conscious remedies, and weak respect for prior precedent will allow this situation to persist. The Wal-Mart suit may be the case that gives us the answer."

### Questions for Discussion

1. Based on the stated human resources philosophy of Wal-Mart, would it be likely that the company would discriminate based on gender differences? Explain.
2. Put yourself in the role of the plaintiffs. What ethical arguments would you offer in support of their allegations?
3. Put yourself in the role of Wal-Mart. What ethical arguments

would you offer to counter the plaintiffs' allegations?

4. What do you think the plaintiffs meant by their allegation that Wal-Mart's culture is a significant contributor to gender discrimination?
5. Is a class action against Wal-Mart justified? Explain your position.
6. Explain how the outcome of *Dukes v. Wal-Mart Stores, Inc.* (regardless of how it is resolved) is important for major stakeholders in the case, including the American society.

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Wal-Mart's corporate Web site asserts that: "Wal-Mart will not tolerate discrimination in employment on the basis of race, color, age, sex, sexual orientation, religion, disability, ethnicity, national origin, veteran status, marital status or any other legally-protected status." Against this backdrop of professed commitment to equal opportunity, Wal-Mart faces an ongoing battle in the gender discrimination class action suit *Dukes v. Wal-Mart Stores, Inc.* filed on June 19, 2001 in United States District Court for the Northern District of California. This case was written by Michael K. McCuddy, the Louis S. and Mary L. Morgal Chair of Christian Business Ethics and Professor of Management, College of Business Administration, Valparaiso University.

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## Case 20

### “Don’t Ask, Don’t Tell”: A Policy on Gays in the Military

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The “Don’t Ask, Don’t Tell” policy was implemented in 1993 by President Clinton at a time when gay individuals were banned from military service. The rationale behind the “Don’t Ask, Don’t Tell” policy is that gays are allowed to serve in the military but must not openly declare their sexual orientation. That is, “the government would no longer ‘ask’ recruits if they were gay, and so long as military personnel didn’t ‘tell’ anyone of their sexual preference—and didn’t engage in homosexual acts—they were free to serve.” (This legislation is currently filed under 10 USC Section 654.) President Clinton “sought equal rights and full participation for gays in the armed forces” but decided to implement this policy because he was forced to compromise “in the face of strong congressional opposition.” Under 10 USC Section 654 (1/06/07), “the presence in the armed forces of persons who demonstrate a propensity or intent to engage in homosexual acts would create an unacceptable risk to the high standards of morale, good order and discipline, and unit cohesion that are the essence of military capability.”

The term “homosexuality” is not mentioned in the United States Constitution. Some historical scholars believe that the founding fathers most likely did not give this topic any thought, since openness about homosexuality was feared. The founders, scholars believe, did not intend for members of the armed forces to be “closet homosexuals.” Again, President Clinton wanted equal rights and full participation for gays in the military, but was pressured to implement this policy because of pressure to compromise from strong congressional opposition. “In 1997, a district court ruled that the policy of ‘Don’t Ask, Don’t Tell’ was unconstitutional, but this decision was reversed by a federal appellate court. Although the appellate court’s decision was further appealed, the Supreme Court refused to review the case.”

**Arguments to uphold “Don’t Ask, Don’t Tell”** Arguments in support of the “Don’t Ask, Don’t Tell” policy are that military life is fundamentally different from civilian life because of the unique responsibilities that military service entails. Also, the military community constitutes a specialized society governed by its own laws, rules, customs and traditions, including restrictions on personal behavior that would be unacceptable in civilian society.

Supporters of “Don’t Ask, Don’t Tell” argue that letting gays and lesbians serve openly “would destroy overall morale and erode good discipline and order,” putting soldiers at risk. Those holding these views argue that the “Don’t Ask, Don’t Tell” policy is fair and just, and that it is not an issue of free speech. The gay or lesbian individual who does not openly declare his/her sexual orientation is not recognized as homosexual, and enjoys all of the rights and privileges of heterosexuals in the armed forces. Speaking out about his or her sexual preference is, in their view, similar to crying “fire” in a crowded theater. The gay or lesbian individual who reveals his/her sexual preference creates a distraction, with the potential of also putting self and fellow soldiers at deadly risk.

Supporters of the policy also argue that the rigors of war have led to a long tradition of military law in this country, a tradition that has long recognized that a soldier serving in the military is subject to different expectations of behavior and to a framework of military justice different from the justice applied to civilians, who do not serve their country in so critical a role. Furthermore, supporters argue that the current “Don’t Ask, Don’t Tell” policy is effective since it allows gay individuals the opportunity to serve in the armed forces without sacrificing the efficiency of the military, whereas openly gay members of the military would create fear in other

members of the military, thereby weakening its effectiveness.

With respect to banning homosexual acts among people in the military, supporters of “Don’t Ask, Don’t Tell” point out that the founding fathers did not mention the right to privacy, and the word “privacy” does not appear in the Constitution. In the 1986 Supreme Court case, *Bowers v. Harwick*, the Supreme Court upheld Georgia state law, stating that “the Constitution does not confer a fundamental right upon homosexuals to engage in sodomy.” However, subsequently, “in a landmark decision the Supreme Court struck down the sodomy laws in the United States. The 6–3 decision in *Lawrence and Garner vs. Texas* overturned the 1986 5–4 majority in *Bowers v. Hardwick* which upheld Georgia’s sodomy law on the basis of traditional morality.”

Fast forward to the twenty-first century, and we find that the most enthusiastic supporters of the policy are primarily conservatives and conservative lobbyists wanting to maintain the status quo, arguing that openly gay individuals in the military would create a distraction in the armed forces and affect unit cohesion. This argument, in their view, justifies a degree of discrimination against gays and lesbians in the military. After all, this was Congress’ original intent in passing the “Don’t Ask, Don’t Tell” legislation.

**Opposition to “Don’t Ask, Don’t Tell” (i.e., Lifting the Ban on Gays in the Military)** The policy is facing numerous tests in the courts. Dozens of members of the armed forces who were discharged for being gay or lesbian are filing suit against the military’s policy. Military members feel forced to leave not because they are gay, but because they are tired of pretending that they are not gay.

There is a strong movement from political activists to have the “Don’t Ask, Don’t Tell” policy repealed. There are many reasons why this policy is argued to be impractical and discriminatory. For example, becoming

a member of the armed forces has been a way for American youth to pay their way through higher education after high school. The “Don’t Ask Don’t tell” policy sends the message that if they choose to “openly” express their (homo)sexuality, the armed forces is no longer an option to help pay education costs. Also, “about 12,000 service members have been booted from the military since the law took effect, including dozens of Arabic speakers whose skills are particularly prized by the military since the advent of the war on terror. While the number discharged for their sexual orientation has fallen from 1,273 in 2001 to 612 in 2006, Pentagon officials insist they are applying the law as fairly as ever.” But “gay-rights advocates disagree, suggesting that the military—pressed for personnel amid an unpopular war—is willing to ignore sexual orientation when recruiting becomes more difficult. A CNN poll found that 79% of Americans believe that homosexuals should be allowed to serve in the military.” “Americans in the military seem less friendly to the idea of junking the ban. A 2006 opinion poll by the independent *Military Times* newspapers showed that only 30% of those surveyed think openly gay people should serve, while 59% are opposed.”

Elaine Donnelly, president of the non-profit Center for Military Readiness, which supports continuing the ban, stated that “The law respects the power of sexuality and the normal human desire for modesty in sexual matters.” There are numerous examples of soldiers who are “too valuable” to be discharged from service for disclosing their homosexuality. According to Steve Ralls, director of communications for the Servicemembers Legal Defense Network (SLDN), the ‘Don’t Ask, Don’t Tell’ has not worked. It is not serving the interests of the armed forces, nor the interests of gay Americans who want to serve, so it is now time to take the next step and have Congress send a clear message that open service is what they now intend.” A 2007 article in *The Christian Science Monitor*

reported that “a group of 28 retired generals and admirals issued a letter calling on Congress to repeal the 1993 ‘Don’t Ask, Don’t Tell’ act,” demonstrating that there is even a movement from within the military to allow gays to serve openly.

Interestingly, in the political arena of the 2008 United States presidential race, “the top four Republican candidates in the 2008 election—Mitt Romney, Mike Huckabee, John McCain, and Rudolph Giuliani—all vow to keep the anti-gay U.S. military policy known as ‘Don’t Ask, Don’t Tell’ (DADT) in place in their administrations,” while Democratic hopefuls Barack Obama and Hillary Clinton promise to reexamine and possibly repeal the act. But Congress will have to be convinced. The Independent Voters of Illinois-Independent Precinct Organization asked Obama, “What is your position on gays and lesbians in the military?” Obama responded, “I don’t believe it is appropriate that hundreds of our military personnel have been drummed out of the armed forces because their sexual orientation has become known. . . . As a member of the U.S. Senate, I would encourage the Armed Services to revisit the current ‘Don’t Ask, Don’t Tell’ policy, which is unfair to those brave service people and is harming rather than strengthening our armed forces.” It is also interesting to note that “Other than Turkey, the U.S. is currently the only country in NATO that prevents gays and lesbians from serving openly—despite the fact that other countries have proved the feasibility of open service.”

### **Sexual Identity: Heredity or Chosen?**

The science of psychology and the human brain add more fuel to the fire of gay rights activists’ push for change. Recent developments in the field of psychology show that there are unique differences in the hypothalamus of the brain in homosexual and heterosexual persons. The results of these studies strongly suggest that while people can vary their sexual tendencies, they cannot completely change their

source of sexual pleasure. In the era of the founders of the U.S., citizens of the country faced harsh opposition from the church and society if their choices of sexuality deviated from the norm. Today, exploring sexuality is not restricted, but encouraged. “Shared sexual orientation is higher among identical twins than among fraternal twins,” a finding which suggests the influence of genetics on sexual orientation. While the topic of whether sexual identity is genetic continues, the debate on whether individuals in the U.S. military who are homosexual and lesbian should be able to openly disclose this information is not over.

Additionally, recent articles have suggested that U.S. soldiers are using a homosexuality claim in order to be discharged from fighting in Iraq. “Don’t Ask, Don’t Tell” also has become a focus of media interest. CBS’ “60 Minutes” featured a segment on Darren Manzella, a self-professed homosexual Army sergeant who recently returned from Kuwait. The segment alleged that Manzella’s commander had decided not to dismiss him because he was too “valuable.” Those arguing to repeal “Don’t Ask, Don’t Tell” also see the policy as preposterous because, in some instances, it has created a “witch hunt” within the military. For example, if a man or woman in military service openly states that he/she is a homosexual, the commander must then investigate. However, there have been instances in which master sergeants felt it was their duty to inquire on the practices of rumored-gay members of the military. In one such incident, a master sergeant summoned Airman First Class Deana Grossi, 20, into his office without provocation for questioning. Under “Don’t Ask, Don’t Tell” superiors are not permitted to ask about the sexual orientation of troops in their command unless authorized by an investigation instigated by a commander; still, the master sergeant had no such authorization. Opponents to the current “Don’t Ask, Don’t Tell” view such a routine demand as inexcusable and totally inappropriate behavior, which also

creates a hostile environment which is more dangerous than if there were no such policy.

### Is “Don’t Ask, Don’t Tell” Legal?

The First Amendment of the U.S. Constitution states that “Congress shall make no law respecting an establishment of religion, or prohibiting the free exercise thereof; or abridging the freedom of speech, or of the press; or the right of the people peaceably to assemble, and to petition the Government for a redress of grievances.” The possibility that a verbal communication or suggestion from a soldier who is homosexual or lesbian can lead to that person’s termination seems at odds with the First Amendment, especially when he/she signs on to serve the country and offers his or her life (in a time of war) to do so. The current policy has already created an environment that encourages some gay men in the service to alter their behavior toward outwardly “masculine” activities and attitudes from fear and/or to avoid suspicion.

Amendment XIV, Section 1, of the U.S. Constitution, states that “No state shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any state deprive any person of life, liberty, or property, without due process of the law; nor deny to any person within its jurisdiction equal protection of the laws.” It does not seem that individual members of the armed forces can, according to this amendment, be excluded from the military based on their stated sexual preference; this exclusion does not relate to the purpose and goals of the armed forces, nor does it relate to the ultimate goal of optimally protecting the United States of America.

Similarly, the cases *Police Department of the City of Chicago v. Mosley* and *Able v. United States District Court for Eastern District of New York* state that “To invite someone with a homosexual orientation to join the Services, then to throw that person out solely because that orientation is revealed from

something he or she said, and finally to pretend that the discharge was not because of the person’s orientation, might appear to all members, heterosexual and homosexual, less than honorable, with incalculable effect on high morale, good order and discipline, and unit cohesion. . . . Because the Act gives to persons of one status, heterosexual, the chance to exercise the fundamental right of free speech and prohibits it to those of another status, homosexual, defendants must at least show that the policy is ‘tailored to serve a substantial governmental interest.’

Under Federal Equal Employment Opportunity (EEO) laws, employment discrimination based on race, color, religion, sex or national origin is prohibited. In addition, “The Office of Personnel Management (OPM) has interpreted the prohibition of discrimination based on conduct to include discrimination based on sexual orientation.” A person should have the right to speak freely about his or her sexual preference without risk of loss of employment. This is particularly true when the employer is the federal government and the person is working to serve his or her country through military service.

### Questions for Discussion

1. What are the pros and cons of the “Don’t Ask, Don’t Tell” U.S. military policy?
2. What does this policy have to do with business ethics? Explain.
3. Is this issue really a “personal matter,” and not for public debate? Explain.
4. Could this policy be implemented in a U.S. publicly traded company? Why or why not?
5. What is your position on “Don’t Ask, Don’t Tell”? Explain and offer your reasons.

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## Case 21

### Women on Wall Street: Fighting for Equality in a Male-Dominated Industry

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#### **Allison Schieffelin and Morgan Stanley**

On June 12, 2004, Morgan Stanley agreed to pay \$54 million to settle dozens of claims from women who alleged that the securities firm denied them pay increases and promotions due to their gender. The case, filed by the Equal Employment Opportunity Commission (EEOC) on September 10, 2001, resulted from repeated complaints by Allison Schieffelin, a 43-year-old former convertible-bond sales clerk who worked in the firm's institutional-stock division for 14 years. Schieffelin earned more than \$1 million a year, making her one of the highest-paid and highest-ranking women on Wall Street to publicly challenge the industry's pay and promotion practices. Schieffelin claims that she was trapped under a glass ceiling and continuously denied promotion to managing director despite being the top performer in her department. The EEOC claims that in addition to being repeatedly denied promotions and pay raises, women employees in Schieffelin's division "endured coarse behavior and lewd comments from their male colleagues and supervisors." Moreover, firm-organized sales outings with clients to golf resorts and strip clubs excluded women.

Of the \$54 million settlement, \$12 million was paid directly to Schieffelin. About \$40 million will be used to settle complaints from an estimated 100 current and former female employees of the institutional-stock division. The remaining \$2 million was used to enhance anti-discrimination training at the firm. In addition to the monetary settlement, Morgan Stanley must also fund a program to have an appointed outsider monitor hiring, pay, and promotion practices for a three-year period. Although the settlement seems large, it is merely "pocket change" to a firm like Morgan Stanley; the \$54 million represents

approximately 2% of the \$2.45 billion in profits the firm earned in the first half of fiscal 2004.

#### **Background on the *Schieffelin et al. v. Morgan Stanley* Case**

Allison Schieffelin first complained of Morgan Stanley's working environment in a 1995 written review of her boss stating, "He makes the convertible department and the firm by extension an uncomfortable place for women." During that same year, she also submitted an internal complaint about "unwelcome advances" from one of her male managing directors. At the time, she thought that management would be pleased with the tactful manner in which she handled the issues; however, today she feels management placed her on a "watch list" instead.

In December 1998, after three years of withstanding the men's locker-room type atmosphere in which the male employees openly "swapped off-color jokes and tales of sexual exploits and treated their female colleagues as inferior," Schieffelin took her harassment and discrimination complaints beyond the firm's executives to the EEOC. She hoped that the firm would see that she had been a dedicated employee throughout her entire career and that the issues with the firm's pay and promotion practices needed to be amended. Instead, she claims the firm "embarked on a campaign to get me to quit." She was fired in October 2001 for what the firm claims to be misconduct after a heated confrontation with her supervisor; however, both Schieffelin and the EEOC viewed her firing as illegal retaliation for her discrimination complaints. One year after Schieffelin complained, Morgan Stanley's New York convertibles department, the department in which Schieffelin worked, promoted Gay Ebers-Franckowiak to



managing director—the first female managing director in that department; many people believe that this was no coincidence.

Morgan Stanley denied all discrimination charges and claimed that their female employees were and are treated equally. The EEOC planned to reveal evidence at the trial proving otherwise. The anticipated evidence indicated that some male employees of the firm ordered breast-shaped birthday cakes and hired strippers to entertain at office parties. The evidence supposedly provided statistics regarding the disparities between female and male promotion and pay within the firm. The trial was scheduled to begin July 12, 2004; however, a settlement was wrapped up mere minutes before opening arguments began. As part of the settlement, payroll statistics that showed whether or not there was a pattern of discrimination were sealed.

### **An Isolated Occurrence or an Industry-Wide Problem?**

The allegations made against Morgan Stanley are not new to the securities industry. Several previous cases, in addition to statistics produced by the Securities Industry Association (SIA), indicate that sex discrimination is a persistent problem on Wall Street.

In April 2004, Merrill Lynch agreed to pay \$2.2 million to Hydie Sumner as part of a class-action lawsuit brought by more than 900 women claiming the financial giant had a long history of gender discrimination. Sumner wanted her old job back; she also said that she wanted to be a Merrill Lynch manager in order to make changes at the firm. “I thought, one day, I’ll be a manager and I’ll have a choice, and I won’t manage like him [Stephen McAnally, former manager of the Merrill Lynch San Antonio office],” said Sumner. As of early 2005, Merrill Lynch paid Sumner \$1.9 million but was fighting the other \$300,000, indicating that this payment would “not be considered until the issues relating to Ms. Sumner’s reinstatement at the firm are resolved.”

In a more recent lawsuit, Stephanie Villalba, former head of Merrill Lynch’s private client business in Europe, sued for \$13 million on gender bias charges. She claimed that her male boss had difficulty accepting her in a senior position and as a result, she was “bullied, belittled, and undermined.” In early 2005, an employment tribunal in the United Kingdom ruled in favor of “Villalba’s claim of victimization on certain issues, that included bullying e-mails in connection with a contract, but found no evidence of a ‘laddish culture’ at the bank.” Villalba intends to appeal the ruling.

In February 2004, Susanne Pesterfield, a former broker for Smith Barney, settled her case with the investment firm on the eve of an arbitration hearing. She alleged that during her seven years at the firm, she endured a “pattern of sexual harassment and a male-dominated culture that included trips to strip clubs.” She described a working environment that was “hostile to women and in which women weren’t given the same opportunities to succeed as men were given.” She claimed that her male colleagues were better paid and received better leads for potential clients.

Pesterfield’s accusations were not new to Smith Barney. A class-action lawsuit brought by female employees in 1996 led to a 1998 settlement in which the firm’s parent company, Citigroup Inc., paid out close to \$100 million. The infamous case has been referred to as the “Boom-Boom Room” in reference to the basement “party room” in the Garden City branch of what was then Shearson Lehman Brothers, wherein discrimination and sexual harassment occurred. Among other things, the conversations that took place among the male employees went beyond their accomplishments on the trading floor to include their latest accomplishments in the bedroom. Shearson’s manager took a “boys will be boys” approach that encouraged obscene comments and lewd behavior.

In her book, *Tales from the Boom-Boom Room*, Susan Antilla provides a

detailed account of the workplace culture at Shearson. According to Antilla, "it was a time when men in branch offices of brokerage firms were encountering significant numbers of female colleagues for the first time. For some of them, it was unsettling." In the late 1990s, many well-educated women entered the financial services industry in hopes of finding great opportunities. Instead, they found an industry that continued to be dominated by white males and an environment that belittled and repressed women.

The acts of alleged sex discrimination abound; nearly 3,000 women filed claims in 1996 and 1997 against Smith Barney and Merrill Lynch. Although most of the women settled, some did not, including Nancy Thomas, Sonia Ingram, Laura Zubulake, Deborah Paulhus, and Neill Sites. Perhaps most notable is the case of Nancy Thomas, a broker at Merrill Lynch for 18 years. Among the numerous allegations of sex discrimination made by Thomas, one is particularly salacious. Thomas alleges that in 1991 "someone left her a package in the mailroom with a dildo, lubricating cream, and an obscene poem." An arbitration hearing was held in New York on September 13, 2004; arbitrators scheduled an additional 18 hearing sessions through July 2005. Merrill Lynch maintained that none of the testimony given as of late November 2004 "support[ed] even one of Thomas's allegations."

**Wall Street's Glass Ceiling—The Numbers Tell the Story** *The 2003 Report on Diversity Strategy, Development & Demographics* produced by the Securities Industry Association (SIA) presents data suggesting there has been little improvement in the advancement of women in the securities industry in recent years, and that biased pay and promotion practices are not just outdated. Even though Wall Street firms seem to be making attempts to improve the workplace environment for women, statistics prove that a strong glass ceiling still exists. There was a gradual decrease in the percentage of

women in the industry between the years 1999 and 2003 (43% and 37%, respectively), and management positions in 2001 and 2003 continued to be dominated by white males. In 2003, white males held 85% of (branch) office manager positions, 76% of the managing director positions, and 79% of the executive management positions. This compares to 85%, 81%, and 75% for the three position categories in 2001. The same is true for line positions such as brokers (80% in 2001 versus 78% in 2003), investment bankers (77% versus 71%), and traders (71% versus 74%). On the other hand, "white women and men and women of color continue to comprise the majority (89%) of the staff and junior level positions."

These numbers become even more disturbing when one considers that women are not new to the profession. In 1974, women held 33.8% of all securities industry jobs with 6.5% being management positions. Muriel F. Siebert, chair of Muriel Siebert & Co. and the first woman with her own seat on the New York Stock Exchange, has worked on Wall Street since the 1950s. She claims that highly educated and successful women are consistently "dropping out" of the industry and changing careers because they feel they have no chance of reaching top management positions.

Catalyst, a nonprofit research organization working to advance women in business, conducted a study of female professionals in the securities industry. Published in 2001 as *Women in Financial Services: The Word on the Street*, the results indicated the top three barriers to women's advancement were lack of mentoring opportunities, commitment to personal and family responsibilities, and exclusion from informal networks of communication. The survey also highlighted the differences in the viewpoints of male and female professionals with respect to the advancement of women. While 65% of women believed they had to work harder than men to get the same rewards, only 13% of men believed

this to be true; 51% of women felt they were paid less than men for doing the same work, while only 8% of men agreed with this statement. In addition, 50% of men believed that women's opportunities to advance to senior leadership in their firms had increased greatly over the preceding five years, but only 18% of women agreed. Many of the women who file complaints, as well as their lawyers, maintain that the perceptual divide between genders is a serious issue. They argue that the men in charge at Wall Street firms do not recognize the existence of a problem, and therefore they fail to look at the statistics and to see the "big picture."

### **Mandatory Arbitration and Coercion Prevent Statistics from Appearing in Court**

In 1986, the Supreme Court ruled that sexual harassment is illegal under Title VII of the 1964 Civil Rights Act. However, recent statistics and settlements in gender discrimination suits suggest that the glass ceiling, at least within the securities and investment banking businesses, still exists. What makes Wall Street such a laggard when it comes to the treatment and advancement of women? One factor could be that before 1999 any employee of a Wall Street firm was required to resolve all disputes in a "closed-door negotiation process" rather than in a public hearing. As the rest of corporate America was hit with discrimination lawsuits in the 1980s and 1990s, the problems occurring on Wall Street remained, for the most part, behind closed doors. After the Boom-Boom Room case and the Merrill Lynch suit in the late 1990s, the Securities and Exchange Commission removed the mandatory arbitration requirement for Wall Street employees who had civil-rights claims. As a result, "the National Association of Securities Dealers and the New York Stock Exchange changed their arbitration rules in a way that permitted employees to sue under federal discrimination statutes in federal court."

### **Why Should the Securities Industry Make Changes?**

Sex discrimination lawsuits have been costly, in terms of money and negative publicity, for securities firms. Avoiding such costs in the future is a strong motivation for change, but not the only one. Another powerful reason is the increasingly influential role of women in business. In 1998, women owned close to 8 million U.S. businesses, which was one-third of the total, and "more than 40% of households with assets of \$600,000 or more [were] headed by women." In 2004, 10.6 million firms were at least 50% female-owned; 48% of all privately held firms were at least 50% female-owned.

Moreover, as more working women approach retirement age and younger women rise in the ranks, securities firms desire to increase their female clientele. As a result, there is an increasing demand for female brokers to serve the needs of this "new" client base. Women investors tend to prefer doing business with a friendly, trustworthy advisor rather than just a person with financial expertise, and thus they aim to establish a personal relationship with their brokers/advisors. To serve an increasingly diverse client base, investment firms must recognize that they will need a diverse group of employees who recognize and react appropriately to the needs of their clients.

### **Who Wins, Who Loses?**

Richard Berman, the judge in the recent Morgan Stanley case, described the \$54 million settlement as a "watershed event in protecting the rights of women on Wall Street." Many others, including Elizabeth Grossman, an EEOC lawyer on the case, hope that the settlement will act as a revelation for not only Morgan Stanley but other Wall Street firms as well. The settlement may cause other firms within the securities and investment banking industry to reevaluate their pay and promotion practices. Additional complaints may also surface because of the settlement.

Although some people view the settlement in a positive light, others see a negative side. As part of the settlement, claimants agreed not to disclose any of the statistics and facts that would have been presented in the case. Although the women who will share the \$54 million settlement scored a big win, some people believe that Morgan Stanley and other securities firms “scored an even bigger win” by preventing embarrassing statistics from being revealed in the courtroom and to the public.

The securities and investment banking firms seem to have a “what the public doesn’t know, won’t hurt them” attitude. Unless the compensation and promotion statistics of those firms are exposed to the public, Wall Street businesses will continue operating within its current culture. In “Money Talks, Women Don’t,” an article about the Morgan Stanley settlement, Susan Antilla stated, “Ingrained cultural misconduct changes only when customers, colleagues, and the public get wind of the nasty facts and companies are embarrassed. Those who can afford to keep their problems quiet may never have to change.”

**Today on Wall Street** Some aspects of work on Wall Street have improved for women, but changing the culture of an entire industry cannot happen overnight, especially if firms are reluctant to admit that a problem exists. Antilla suggests that there has been reluctance to address the discrimination and harassment issues even after they were revealed in the Boom-Boom Room and Merrill Lynch lawsuits of the late 1990s. Antilla says, “When it came to acknowledging that there was still a problem to work on—violators to stop and biases to correct—Wall Street had become a little like the dysfunctional family hiding the crazy uncle in the attic. Everyone knew sexual harassment was there and indeed had put much energy into urgently and quietly negotiating the crises that resulted from it. But

hardly anyone spoke openly about the problem—called the doctor, if you will—and started the real work of making things better.”

Today, firms are more likely to have diversity programs and sexual harassment training. Many companies have altered their recruiting processes and several have established partnerships with support organizations that promote equal opportunities in professions for women and minorities. Some companies are working at changing the “tone at the top” by promoting women to top positions and challenging old attitudes within the companies. For example, in late 2002 Smith Barney hired its first woman chief executive, Sallie Krawcheck. Since then, the company has fired some of its most successful brokers for mistreating female co-workers, thereby sending a message that such behavior will not be tolerated—even in the most valued employees. Despite these efforts, the industry statistics and continual lawsuits suggest that women in the financial services industry are not playing on a level playing field quite yet.

Indeed, as one Wall Street observer, Dan Ackman, a columnist for *Forbes* magazine, noted, “beyond the numbers, nearly every woman on Wall Street will tell you there are, to this day, subtle and not-so-subtle double standards and a still pervasive atmosphere of harassment.” As the business writer John Churchill reports, “Many complainants claim the firms have just become subtler in their discrimination, rigging teams, for instance, so that when men retire or change firms, the most lucrative accounts they leave behind get assigned to other members of the old-boy network, not to the most senior broker in the office.” Consequently, the most important question with respect to sexual discrimination in the securities and investment banking industry may be, “What must happen in order for a true and pervasive cultural change to take place on Wall Street?”

## Questions for Discussion

1. Is business ethics relevant to the topic and examples in this case or is this just business as usual? Explain.
2. What are the ethical implications of the one-time arbitration requirement that prevented Wall Street employees from seeking redress through the court system?
3. Why is the securities and investment banking business male-oriented and dominated?
4. Why does sex discrimination seem to persist on Wall Street in spite of the negative publicity of lawsuits and monetary costs of settlement?
5. What can or should be done to transform the persistent culture of sex discrimination on Wall Street?
6. Would you like working on Wall Street as a woman? Explain.
7. As a man or woman, what lessons would you take from this case if you accepted a professional job in a Wall Street firm?

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# 8

## BUSINESS ETHICS & STAKEHOLDER MANAGEMENT IN THE GLOBAL ENVIRONMENT

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Ethical Insight 8.1

### 8.2 Managing and Working in a “Flat World”: Professional Competencies and Ethical Issues

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## OPENING CASE

“Imagine 100 companies—many virtually unknown in developed countries—with combined 2006 revenues of \$1.2 trillion and total 2006 purchases exceeding \$500 billion. (Emerging market economies also raised global aggregate output growth to about 7.5% in 2007). Next, imagine you’re sitting in corporate headquarters in London, Madrid, Paris, Rome, Frankfurt, New York, Chicago, San Francisco, Toronto, Tokyo—and you realize these companies are coming at you from everywhere: Argentina,

Brazil, Chile, China, Egypt, Hungary, India, Indonesia, Malaysia, Mexico, Poland, Russia, Thailand, and Turkey. Twenty years ago we referred to many such places as Third World countries. Today the 14 countries listed above are major centers of economic growth, attracting \$245 billion in foreign direct investment in 2006 and generating some 17.3% of total global gross domestic product. The countries are increasingly home to your competition. They also are home to current or potential customers,

suppliers, and partners. . . Welcome to the globaleconomy, circa 2008. Unheard-of companies from rapidly developing economies (RDEs) are challenging the biggest and best in the world. If you require confirmation, just ask employees of Canadian mining company Vale Inco, which was purchased in 2006 by Brazil's Companhia Vale do Rio Doce for \$17.8 billion. Or ask employees of Anglo-Dutch steelmaker Corus, acquired in early 2007 by India's Tata Steel for \$12 billion. Or ask the employees of Ford's (F) Jaguar and Land Rover divisions, which may soon become subsidiaries of India's Tata Motors. . . . No company can afford to ignore these challenges. No company is immune. And no company has any reason to be surprised. . . ."1 At the same time, consider Goldman Sachs, Deutsche Bank, Credit Suisse, Banco do Brasil, and fifteen other multinational investment banks who reported that "[We] are convinced that in a more globalized, interconnected and competitive world

the way that environmental, social and corporate governance issues are managed is part of companies' overall management quality needed to compete successfully. Companies that perform better with regard to these issues can increase shareholder value by, for example, properly managing risks, anticipating regulatory action, or accessing new markets, while at the same time contributing to the sustainable development of societies in which they operate. Moreover, these issues can have a strong impact on reputation and brands, an increasingly important part of company value."<sup>2</sup>

If you are a new or an experienced hire in a global company or in a firm facing these challenges, you may have "your work cut out for you." You may also want to "globalize" your own thinking and skills—if you haven't already—and gain awareness of the wider ethical impacts of your work, your company, and your stakeholders—in international settings.

## 8.1 THE CONNECTED GLOBAL ECONOMY AND GLOBALIZATION

The global environment consists of a dynamic set of relationships among financial markets, cultures, politics, laws, technologies, government policies, and numerous stakeholders and stakeholder interests. As the opening case indicates, the new "flat world" consists of hypercompetition from different country and regional players across the globe. This global environment also involves individual citizens, families, and communities that are—and many that are not—served by multinationals. This chapter presents different dimensions of globalization that affect new and experienced managers and professionals, and people in every nation. Ethical Insight 8.1 defines and describes globalization in this broader context.

We begin by identifying the forces underlying the globalization process in general, and then present ethical issues which companies in the global environment face. Then, competencies that managers and professionals need to compete when doing business internationally are presented. We then discuss the societal "dark side" of ethical issues and globalization, followed by a presentation of multinational corporations (MNCs) as stakeholders and their host-country relationships. We will conclude by identifying negotiation methods for making ethical decisions taking cross-cultural contexts into consideration.

## ETHICAL INSIGHT 8.1

## What Do We Mean By Globalization?

We have six billion people on the planet . . . five billion of them in developing countries. The one billion in the developed world has 80% of the assets, the five billion have 20%. . . . The inequities are considerable and we have 2.8 billion people who are living under two dollars a day, and 1.2 billion under one dollar a day. And we find in fact in so many parts of the world that the equity is in fact diminishing in terms of rich and poor rather than improving.

What do we mean by globalization? Globalization is about an increasingly interconnected and interdependent world; it is about international trade, investment, and finance that have been growing far faster than national incomes.

It is about technologies that have already transformed our abilities to communicate in ways that would have been unimaginable a few years ago. It is about our global environment, communicable diseases, crime, violence, and terrorism. It is about new opportunities for workers in all countries to develop their potential and to support their families through jobs created by greater economic integration.

But it is also about international financial crises, about workers in developed countries who fear losing their jobs to lower-cost countries with limited labor rights. And it is about workers in developing countries

who worry about decisions affecting their lives that are made in far-away head offices of international corporations.

Globalization is about risks as well as about opportunities. We must deal with these risks at the national level by managing adjustment processes and by strengthening social, structural, and financial systems. And at the global level, we must establish a stronger international financial architecture and work to fight deadly diseases, to turn back environmental degradation, and to use communications to give voice to the voiceless.

We cannot turn back globalization. Our challenge is to make globalization an instrument of opportunity and inclusion—not of fear and insecurity. Globalization must work for all.

There are more challenges ahead, and bigger ones.

In the next 25 years, world population will go up by 2 billion to a total of [between] 8 [to 9.5] billion people, with 98% of that increase in the developing world. The population of Europe will shrink, while that of the United States will go up a little, but largely from migration.

As we go forward the voices of the poor must be our guide.

Time is short. We must be the first generation to think both as nationals of our countries and as global citizens in an ever shrinking and more connected planet. Unless we hit hard at poverty, we will not have a stable and peaceful world.

*(continued)*



(Continued)

Our children will inherit the world we create. The issues are urgent. The future for our children will be shaped by the decisions we make, and the courage and leadership we show today.

**SOURCE:** Wolfensohn, J. D. (February 16, 2004). Financing the Monterrey Consensus—Remarks at the conference: Making globalization work for all. The World Bank Group, <http://web.worldbank.org/>  
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 Ibid. Brackets include estimate from Walker, Robert (July 1, 2008) World Population Day, 9 Billion? <http://www.prcdc.org/blog/>

**Globalization and the Forces of Change** Because globalization involves the integration of technology, markets, politics, cultures, labor, production, and commerce, it is both the processes and the results of this integration. The global economy has been estimated at \$33 trillion. Although globalization has facilitated economic growth over several decades, this process is also vulnerable to forces in the environment, as discussed in this chapter. The most recent threats to economic stability and growth are the subprime lending crisis, out-of-control investment practices, dysfunctional governmental regulation, rising oil and energy prices, and global terrorism, all of which continue to generate costs to businesses and the public. Economic outlooks vary with regard to the global economy: some predict the size growing to \$72 trillion by 2030, while others see slowed growth and near collapse if responsible regulation is not restored to government, financial and investment systems, as recent financial crises show.<sup>3</sup> Nevertheless, technological emerging markets and innovation continue to support the globalization process; some of these forces include:

- The end of communism, which has allowed the opening of closed economies. The so-called EMEs (emerging market economies) in Asia, Latin America, Europe, Russia, Africa, and the Middle East have added to the growth of the global economy, as discussed in the opening case. Although this growth is cyclical, countries in these regions show continuing strength in their economic development.<sup>4</sup> As noted above, the rise of EMEs means greater business competition. “In Europe as of 2006, no fewer than 48 small, no-frills airlines in 22 countries had sprung up to capture about 28% of the Continental market share. No company is too large to be a takeover target if it dominates a profitable market or has other features attractive to profit-hungry investors.”<sup>5</sup>
- The emergence of China as a global manufacturer and U.S. trading partner, and India—ranking third in domestic market size and fourth in foreign market size—as a source of world-class offshore technology services. The U.S. goods deficit with China increased from \$16.1 billion

in March, 2008 to \$20.2 billion in April.<sup>6</sup> China's growth rate of 11% and India's at 9% may experience a slowdown because of the subprime and other financial crises, but the prominence of these two countries in the global economy continues to grow.

- Information technologies and the Internet also accelerate communication and productivity within and across companies globally. Today it is fairly easy for any company to globalize using the Internet. Superconductors will be economically ready for many daily applications and will advance to commercial use after 2015. New technologies should continue to improve the efficiency of many industries while lowering costs.
- Free trade and trading agreements continue among nations with open borders. Among them are the European Union (EU)—(see Figure 8.1 for a list of these countries); the North American Free Trade Agreement (NAFTA), which encourages large and small businesses to operate

Figure 8.1

### European Union Countries



Legend: **Light blue** = pre-May 1, 2004 EU Members; **Dark blue** = May 1, 2004.

Acceding Members; **Medium blue** = post-May 1, 2004 Candidate Countries.

**SOURCE:** © European Communities, 1995–2004, [http://www.europa.eu.int/abc/maps/index\\_de.htm](http://www.europa.eu.int/abc/maps/index_de.htm).

in Canada and Mexico; the Association of Southeast Asian Nations (ASEAN), which helps emerging companies to compete with European and U.S. firms; and the World Trade Organization (WTO), which accepted China starting in 2002 and which provides a framework that “creates stability and predictability so that investors can, with more security, plan their activity. . . .”<sup>7</sup> Global trade has tripled over the past 25 years.

- The World Bank and the International Monetary Fund (IMF) offer a conduit for needed capital flows to countries participating in building the global economy—as China, India and emerging economies continue to gain wealth and influence. The euro and other Asian currencies will slowly but steadily compete to replace the U.S. dollar as the global basis of exchange rates. China currently holds over \$1.5 trillion in U.S. foreign reserves (forex).
- “Global terrorism” and counter responses since September 11, 2001 continue to present regions, countries, and businesses with sizable risks and costs. For example, from an American perspective, the U.S.-led “war on terrorism” in Iraq has resulted in the death of 4,116 U.S. troops with 30,316 wounded. One estimate of the total projected costs of the war to the U.S. is over \$3 trillion dollars. An estimated \$600 billion of U.S. taxpayers’ funds have been spent throughout 2008. A cumulative total close to \$800 billion is projected to be spent by 2009. The U.S. has spent approximately \$12 billion a month, that is, roughly \$5,000 a second, on the Iraq War during the year 2008. Deploying a U.S. soldier for one year in Iraq costs \$390,000.<sup>8</sup> The continuing costs of preventing and managing terrorist risks in the U.S. and other countries is substantial to the global economy and to affected industries, such as the U.S. airlines.
- Multinational enterprises (MNEs) continue to grow, open new markets, and create jobs across the globe. “Of the 100 largest economies in the world, 51 are corporations; only 49 are countries (based on a comparison of corporate sales and country GDPs).”<sup>9</sup> Examples of such transnational giants include General Electric, Texaco, British Petroleum Amoco, Shell Oil, Ford, Procter & Gamble, Coca-Cola, and Heinz, to name only a few. An estimated 40,000 to 100,000 multinational companies continue to do business across national boundaries and contribute to the global economy. It is likely these numbers will increase. Where there are new markets, companies will move and be created. At the same time, MNEs will spend more on risk management, as noted above, which in turn will encourage outsourcing, rather than investing in offshore facilities that are vulnerable to political instability.
- Global poverty and income disparity also multiply: “Half the world—nearly three billion people—live on less than two dollars a day. More than 80 percent of the world’s population live in countries where income differentials are widening. The poorest 40 percent of the world’s population accounts for five percent of global income. The richest 20 percent accounts for three-quarters of world income. According to UNICEF, 26,500–30,000 children die each day due to poverty. . . . Nearly a billion people entered the 21st century unable to read a book

or sign their names.” There are 2.2 billion children in the world; 1 billion live in poverty.<sup>10</sup> These conditions create and add to the instability of governments, the rule of law, and political regimes; and to the influence of global terrorism.

- Consumers are demanding social responsibility from corporations. “Companies increasingly are being judged on how they treat the environment. Many are changing their business practices as a result. For example, home-improvement retailers Home Depot and Lowe’s have stopped buying wood from countries with endangered forests. Institutions are growing more transparent in their operations and more accountable for their misdeeds.” China was evaluated by the Kurtzman Group as the most opaque of the major nations; the country “. . . was forced to open many of its records as a precondition for joining the World Trade Organization.” India opened its banking system to more effective oversight.<sup>11</sup>
- A shift to service economies and knowledge workers using technologies has also propelled innovation and productivity worldwide. Knowledge workers will work in flatter, more networked, geographically dispersed organizations. Leadership will be shared and individual professionals will be required to work in virtual as well as land-based teams as electronic communications accelerate.

## 8.2 MANAGING AND WORKING IN A “FLAT WORLD”: PROFESSIONAL COMPETENCIES AND ETHICAL ISSUES

As the forces driving globalization indicate, this process is complex with results that differ in benefits and burdens depending on who the stakeholders are. We try to identify and discuss major effects of globalization on these different stakeholders in this chapter. We continue with the professional entering the global workforce. As the opening case indicated, globalization brings hypercompetition and challenges to new and continuing leaders and professionals in corporations. This section begins with three questions: (1) Is there an ideal profile of competencies for global managers and professionals who will work in different countries? (2) Is there a global set of values and ethics that benefits transnational companies, their managers, and professionals? and (3) What are ethical issues these professionals might expect to find? The following quote by David Tai, director of HR Learning at IBM India/South Asia, who prepares employees for global leadership, is relevant here:

Today’s global economy is a knowledge economy, which requires fresh thinking and innovative approaches to workforce management. In fact, IBM’s latest human capital management study reveals that 75 percent of global business leaders are worried about the ability to build globally aware leaders; 88 percent of those respondents are from Asia.<sup>12</sup>

There is a demand for “a new type of cosmopolitan, multinational, multifaceted executive who is operational across national borders.”<sup>13</sup> Brian Hum, an HR specialist in globalizing workforces, noted that there are two

pre-conditions that must be met for international business managers to adapt successfully:

They must want to operate effectively in another culture and they must be excited by the challenges ahead. Attempting to learn a foreign language to a reasonable standard is another favorable indicator. International business managers need to be sensitive to foreign cultures with no sign of prejudice. Their ability to cope with ambiguity, particularly when dealing with different business cultures and ethical dilemmas is an essential competence. . . . Previous overseas experience . . . is not necessarily an indicator of future successful performance.<sup>14</sup>

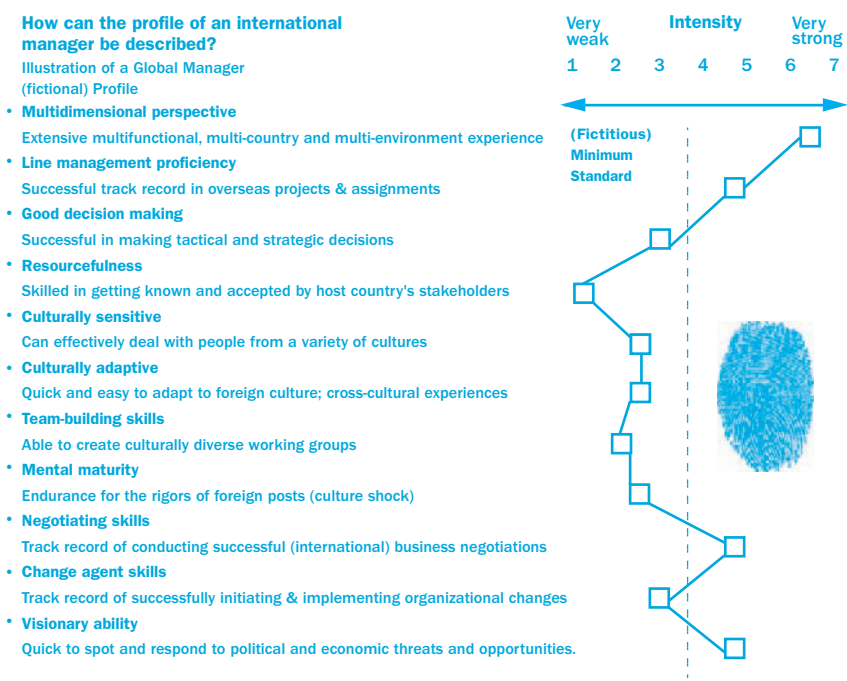
Paul C Reilly, Chairman and CEO of Korn/Ferry International, a leading global executive search firm, stated that “The strongest global executives, we believe, will possess four key attributes:

1. A deep understanding of both their local and global markets
2. Solid business fundamentals
3. The ability to attract and retain top talent
4. The ability to champion new world thinking.”<sup>15</sup>

While there are no definitive empirical or longitudinal studies that confirm skills of an ideal global manager or professional,<sup>16</sup> research offers expertise areas for succeeding in international and global careers. Figure 8.2 illustrates

Figure 8.2

Global Leadership Skills



**SOURCE:** Based on Prof. Dr. Rainer Busch (April 24, 2008). Global Leadership Skills <http://www.rainerbusch.de/GLS-24-04-2008-Busch.pdf>, accessed July 10, 2008.

one such example. You will notice certain reoccurring competencies as you review these lists. Figure 8.3 extends the managerial competencies in Figure 8.2 with ethical dimensions of those skills. For example, having a managerial “multidimensional perspective”(i.e. “Extensive multifunctional, multi-country and multi-environment experience”) would be complemented with having a “multidimensional ethical perspective” which would, as shown in Figure 8.2, require experience in managing cross-cultural country values and ethical orientations.

Figure 8.3

### Managerial and Complementary Ethical, Social Responsibility Competencies

<ul style="list-style-type: none"> <li>• <b>Multidimensional perspective</b> Extensive multifunctional, multi-country and multi-environment experience</li> </ul>	→	<ul style="list-style-type: none"> <li>• <b>Multidimensional/ethical perspective</b> Extensive multifunctional, multi-country and multi-environment experience in managing values and ethical orientations.</li> </ul>
<ul style="list-style-type: none"> <li>• <b>Line management proficiency</b> Successful track record in overseas projects and assignments</li> </ul>	→	<ul style="list-style-type: none"> <li>• <b>Line management social responsibility</b> Successful track record in bringing social responsibility to overseas projects and assignments</li> </ul>
<ul style="list-style-type: none"> <li>• <b>Good decision making</b> Successful in making tactical and strategic decisions</li> </ul>	→	<ul style="list-style-type: none"> <li>• <b>Ethical decision making</b> Ability to apply ethical principles tactically and strategically</li> </ul>
<ul style="list-style-type: none"> <li>• <b>Resourcefulness</b> Skilled in getting known and accepted by host country's stakeholders</li> </ul>	→	<ul style="list-style-type: none"> <li>• <b>Ethical resourcefulness</b> Skilled in getting known and accepted by host country's stakeholders with regard to being and demonstrating ethical thinking and decision-making</li> </ul>
<ul style="list-style-type: none"> <li>• <b>Culturally sensitive</b> Can effectively deal with people from a variety of cultures</li> </ul>	→	<ul style="list-style-type: none"> <li>• <b>Cross-cultural ethics awareness</b> Can understand and effectively communicate with other people's cultural values and ethical principles</li> </ul>
<ul style="list-style-type: none"> <li>• <b>Culturally adaptive</b> Quick and easy to adapt to foreign culture; cross-cultural experiences</li> </ul>	→	<ul style="list-style-type: none"> <li>• <b>Cross-cultural ethics adaptation</b> Quick and easy to adapt to foreign values and other cultural ethical perspectives</li> </ul>

(continued)

● Figure 8.3

**Managerial and Complementary Ethical, Social Responsibility Competencies (continued)**

- |   |   |   |
|---|---|---|
| • <b>Team-building skills</b><br>Able to create culturally diverse working groups                               | → | • <b>Team-building social responsibility skills</b><br>Able to bring and adapt to practical ethical awareness of diverse working groups and relationships                           |
| • <b>Mental maturity</b><br>Endurance for the rigors of foreign posts (culture shock)                           | → | • <b>Moral maturity</b><br>Ability to work with rigors of new and different levels of professionals' moral maturity over time (moral diversity shock)                               |
| • <b>Negotiating skills</b><br>Track record of conducting successful (international) business negotiation       | → | • <b>Negotiating skills across country cultures</b><br>Track record in successfully negotiating conflicting country norms and outcomes among individuals, groups, and organizations |
| • <b>Change agent skills</b><br>Track record of successfully initiating and implementing organizational changes | → | • <b>Change agent ethical skills</b><br>Track record of effectively bringing ethical dimensions to organizational changes   |
| • <b>Visionary ability</b><br>Quick to spot and respond to political and economic threats and opportunities     | → | • <b>Stakeholder management skills</b><br>Quick to spot and respond to political, economic, ethical, and social threats and opportunities.  |

**SOURCE:** Based on Prof. Dr. Rainer Busch (April 24, 2008) and adapted by Joseph W. Weiss, Bentley College, 2009. All rights reserved.

Another complementary list of global skills that are based on research and HR (human resource) experience includes the following:<sup>17</sup>

- |  |                                    |
|--|------------------------------------|
| • Strategic awareness                    | • Self-reliance                    |
| • Adaptability to new situations         | • Open, non-judgmental personality |
| • Sensitivity to different cultures      | • Flexibility of thinking          |
| • Ability to work in international teams | • Sensitivity to others            |
| • Language skills                        | • Ability to see the “big picture” |
| • Understanding international marketing  | • Leadership skills                |
| • Relationship skills                    | • Drive and determination          |
| • Family support                         | • Intellectual capability          |
| • International negotiating skills       |                                    |

Many large companies outsource the assessment process for selecting managers and professionals to work abroad. Other firms have in-house assessment centers to evaluate, select, and train professionals for international and global work.

### Shared Leadership in Teams' Competency

Recent research on workplace attitudes and values across 53 nations and regional groupings by professors at the Graduate School of Management in Claremont found that “teams that perform poorly tend to be dominated by the team leader, while high-performing teams have a shared-leadership structure. But beware: There are some risks executives run by sharing the reins. And our research suggests also that success may depend on the particular country where a business is operating.”<sup>18</sup>

The researchers noted that it is more difficult to share leadership if members share values from a society that is based on unequal distribution of power. “Those who occupy leadership positions are less likely to share their authority, since they likely believe it is something they have earned; likewise, followers may be reluctant to share leadership because they view control as the sole prerogative of the appointed leader. Followers may also judge a leader to be weak if he or she attempts to hand over the reins.” Countries, according to these researchers, where there is an unequal distribution of power include: Arab countries, Belgium, Brazil, Chile, Colombia, Costa Rica, East Africa, Ecuador, France, Greece, Guatemala, Hong Kong, Indonesia, Iran, Korea, Malaysia, Mexico, Pakistan, the Philippines, Panama, Peru, Portugal, El Salvador, Singapore, Spain, Taiwan, Thailand, Turkey, Uruguay, West Africa, Venezuela, and Yugoslavia. Countries where power is more decentralized and that are more egalitarian include: Argentina, Australia, Austria, Canada, Denmark, Finland, Germany, Britain, India, Ireland, Israel, Italy, Jamaica, Japan, the Netherlands, New Zealand, Norway, South Africa, Sweden, Switzerland, and the U.S. Of course not every professional from a country in either of these two groupings shares that country's value system; this research is only an indicator. See Ethical Insight 8.2 below and find how you identify your preferences for team leadership, based on your country of origin as well as your beliefs about effective teams and leadership.

Researchers in this study advise companies forming teams as follows: (1) “The Mistake: When companies put together teams of employees, they usually hamstring the group right from the start by appointing one team member to lead the crew; (2) The Alternative: Leadership should be shared among team members, passing to whoever has the most expertise for the job at hand. Our research shows that when teams share leadership, their companies usually see big benefits; (3) The Caveat: Shared leadership doesn't work in all situations—for instance, if the teammates haven't had time to learn each other's strengths and gauge who should be in charge at any given time. Shared leadership also faces big hurdles in some cultures, such as those that generally favor strong central authority.”<sup>19</sup> To summarize, an individual's cultural background, based on country differences, can affect his/her effectiveness as a global team leader and member. Of course this type of difference is not the only factor determining team effectiveness, but being aware



of the effects of others’ and one’s cultural background is important—not only for team membership but also for ethical decision-making differences as we discussed earlier and will address again later in the chapter.

The final observation in this section is that human resource experience indicates that “Fewer young people are willing to accept assignments overseas for fear their experience will not be recognized and they will encounter difficulties when coming back. It is therefore becoming critical for companies to select with precision and recruit the right personnel.”<sup>20</sup> Other reasons new professionals hesitate to take overseas positions or long-term assignments include the following preconceptions about working away from the base of their company’s operations: “nomadic and transient lifestyle; loss of ties to home and close friendships; [not knowing] how to integrate with local people;

ETHICAL INSIGHT 8.2

Country Culture Counts: Potential for Shared Leadership

Countries that accept unequal power distribution in organizations and institutions; centralized decision-making; unequalitarian:	Countries that do not accept unequal power distribution; decentralized decision-making; egalitarian:
Arab countries, Belgium, Brazil, Chile, Colombia, Costa Rica, East Africa, Ecuador, France, Greece, Guatemala, Hong Kong, Indonesia, Iran, Korea, Malaysia, Mexico, Pakistan, the Philippines, Panama, Peru, Portugal, El Salvador, Singapore, Spain, Taiwan, Thailand, Turkey, Uruguay, West Africa, Venezuela, and Yugoslavia	Argentina, Australia, Austria, Canada, Denmark, Finland, Germany, Britain, India, Ireland, Israel, Italy, Jamaica, Japan, the Netherlands, New Zealand, Norway, South Africa, Sweden, Switzerland, and the U.S.

Questions

1. What is your country of origin? In which country have you lived, studied or worked the longest?

2. Which decision-making style do you prefer in a team: centralized or decentralized? Explain.

3. Which leadership decision-making style do you believe
- would allow for more ethical decisions: (a) centralized (single leader) or (b) decentralized (shared leadership)? Explain.

4. What has been your experience in observing how more ethically oriented teams have performed: Those teams with centralized, authoritarian or decentralized, egalitarian leadership decision-making? Explain.

**SOURCE:** Pearce, Craig (July 7, 2008). Follow the Leaders, Wall Street Journal online, p. R8, [http://online.wsj.com/article/SB121441363110903891.html?mod=djem\\_jiewr\\_HR](http://online.wsj.com/article/SB121441363110903891.html?mod=djem_jiewr_HR)

loss of usual support systems and people to turn to in an emergency; danger of terrorist activities and anti-western attitudes in some areas; and children's education and spouses' careers."<sup>21</sup> Companies must stress the positive opportunities for overseas careers, such as: "wider responsibility, often with greater freedom of action, enhanced quality of life, greater job satisfaction and, if successful, future career advancement, as well as opportunities to travel, to broaden horizons and possibly learn other languages."<sup>22</sup> We turn next to ethics from a global perspective.

## Global Ethical Values and Principles

Because unethical practices cross geographic boundaries and affect nation states as well as corporations doing business in different countries, there is a need for both legal regulation and ethical motivation. An example of a blatant illegal and unethical practice that has affected global business is South Africa's previous apartheid system that was supported by several local laws from 1948–1986. These laws condoned and even enforced racial segregation that protected white supremacy and domination. "Firms with subsidiaries operating in SA were bound by the apartheid legislation even though each of the laws could be ethically faulted."<sup>23</sup> Within that system, multinational corporations had to decide whether to continue supporting a system of racial discrimination and slavery by doing business in South Africa during that time, or leave. Other forms of questionable ethical behavior by different countries will be discussed later in this chapter, including: child labor, intolerable working conditions for employees, foreign firms paying below living wages for cheap labor, exporting proven hazardous products to different countries, and multinationals' usurping poorer countries' environmental and natural resources to gain profit. For these reasons, global values and principles were developed by international agencies and institutions to inform and constrain all corporations doing business across national borders from illegal and unethical acts such as apartheid.

**Examples of Global Principles and Values** There are different universal sets of values and ethical standards that are shared by multinationals. The Global Sullivan Principles are one such source. "These principles were developed by Leon Sullivan (the first African-American to be appointed to the board of a major corporation—General Motors) in 1977. General Motors was the largest American employer of black South Africans at the time."<sup>24</sup> Over thirty prestigious firms have agreed to these principles, which are shown in Table 8.1. Other such global codes, principles, and statements of universal rights can be found at The Caux Round Table ([www.cauxroundtable.org](http://www.cauxroundtable.org)) in Switzerland, Amnesty International Human Rights Principles for Business, The Asian Pacific Economic Cooperation Forum Business Code of Conduct, The CERES Principles, The Clarkson Principles of Stakeholder Management, The ILO Declaration of Fundamental Principles and Rights at Work, The OECD Guidelines for Corporate Governance, The OECD Guidelines for Multinational Enterprises, and The United Nations Declaration of Human Rights.

Table 8.1

Global Sullivan Principles of Social Responsibility

The Principles

As a company which endorses the Global Sullivan Principles we will respect the law, and as a responsible member of society we will apply these Principles with integrity consistent with the legitimate role of business. We will develop and implement company policies, procedures, training and internal reporting structures to ensure commitment to these Principles throughout our organization. We believe the application of these Principles will achieve greater tolerance and better understanding among peoples, and advance the culture of peace. Accordingly, we will:

- **Express our support for universal human rights** and, particularly, those of our employees, the communities within which we operate, and parties with whom we do business.
- **Promote equal opportunity for our employees at all levels of the company** with respect to issues such as color, race, gender, age, ethnicity or religious beliefs, and operate without unacceptable worker treatment such as the exploitation of children, physical punishment, female abuse, involuntary servitude or other forms of abuse.
- **Respect our employees' voluntary freedom of association.**
- **Compensate our employees to enable them to meet at least their basic needs** and provide the opportunity to improve their skill and capability in order to raise their social and economic opportunities.
- **Provide a safe and healthy workplace;** protect human health and the environment; and promote sustainable development.
- **Promote fair competition including respect for intellectual and other property rights,** and not offer, pay or accept bribes.
- **Work with governments and communities in which we do business to improve the quality of life in those communities**—their educational, cultural, economic and social well-being—and seek to provide training and opportunities for workers from disadvantaged backgrounds.
- **Promote the application of these Principles by those with whom we do business.**

**SOURCE:** Global Sullivan Principles of Social Responsibility, The Global Sullivan Principles, <http://www.thesullivanfoundation.org/gsp/principles/gsp/default.asp>.

Guy's (1991) ten core values also serve as a practical set of universal principles:<sup>25</sup>

- |                           |                              |
|---------------------------|------------------------------|
| (1) caring                | (6) loyalty                  |
| (2) honesty               | (7) fairness                 |
| (3) accountability        | (8) integrity                |
| (4) promise keeping       | (9) respect for others       |
| (5) pursuit of excellence | (10) responsible citizenship |

**Does One Set of Values “Fit” All?** Can one set of values apply to different cultures? Gilman and Lewis (1996) argued that universal “. . . principles and common values are often—and wrongly—dismissed because actual behavior does not appear to coincide. . . The apparent incoherence between expressed values and observed behavior does not make values irrelevant to cross-cultural comparisons.”<sup>26,27</sup> The same authors cited empirical data from a study that included France, Germany, the U.S., Japan, Mexico, South Africa, Argentina, Chile, Russia, Nigeria, and India to argue that although culture is a carrier of values, “. . . values are not solely derived from one’s culture.”<sup>28</sup> In other words, there are universal principles and values that are not, nor should they be, culturally-derived; rather, these principles should transcend cultures for the greater good of all. As we will discuss in the last section of this chapter, issues emerge not only from the problem of identifying or agreeing on a set of universal ethical principles, but rather when there is a clash between individuals, groups, and/or organizational interests that are constrained or denied by one or more of these principles. Doing the right thing may violate cultural norms in several cultures; some universal principles may take precedent over some cultural values for the common good as well as for certain individual’s and group’s rights.

### **Know Your Own Cultural and Core Values, Your Organization’s, and Those with Whom You Are Working**

A first step for corporate leaders and professionals working in different countries and globally is: Knowing (1) your own cultural and ethical values and principles, (2) those of your organization or company, and (3) those of the individuals, team, and organization in whose culture you are working. Without this knowledge, two particular “**ethical traps**” may face individual professionals, teams, and companies:

1. Acting **ethnocentrically** is demonstrating “the belief in the inherent superiority of one’s own ethnic group or culture; a tendency to view alien groups or cultures from the perspective of one’s own.”<sup>29</sup> Acting from one’s own cultural preferences without awareness of or concern for others’ cultural values also has ethical consequences that can result in negative reactions from others and your failure to achieve business goals. Critics have accused the U.S. government of acting ethnocentrically in some of its policies and preemptive approaches to imposing democracy on some Middle Eastern countries. Some North American and European corporations in previous decades and empires have also acted ethnocentrically in their use and destruction of poorer countries’ resources for competitive gain.
2. **Moral (and cultural) relativism** is based on “the theory that there are no universally valid moral principles binding on all people at all times, but rather all are valid relative to culture (or individual choice = subjectivism).”<sup>30</sup> At a cultural level, acting from this theory involves “When in Rome, do as they do;” or, do what your company believes is right at the time and in the immediate circumstance. If you had been working with

an American company in South Africa in the 1970s, you may very well have been acting from this principle. You would have been, as noted earlier, accepting the practice of state condoned racial discrimination. Some of the larger petroleum companies working in conjunction with other cohorts have been described as acting from a relativistic ethic to satisfy their own profits at the expense of the environment and poorer working peoples who are barely surviving with increased energy and fuel prices.

A method you can use to understand your own cultural values and ethical principles—and those of your team and even organization—in an international setting is based on Harvard University's Joseph Badaracco's three key questions to consider before acting or taking a position in a "defining moment." His method is presented in Chapter 3; the following is an extension of that method.<sup>31</sup> We have added a cross-cultural dimension to the probes.

- **For individuals**, the key question is "**Who am I?**" *First*, ask and discern "What cultural values, attitudes, and habits might influence my decision?" *Second*, what are my *ethical principles-in-action* (i.e. principles practiced): Do I generally rely on a utilitarianian ethic? Do I rely on justice, fairness, and duty principles? Am I an altruist, pragmatist? Do I respect the rights of others? Or, do I make decisions based on relativism—i.e. act from my own self-interest and cultural values only? Do I demonstrate virtues in my character and toward others? Also, am I flexible in my ethical thinking when dealing with others, or am I rigid and demanding? *Third*, with whom am I making this decision? Do I understand their basic cultural values? Do I know some of their *ethical principles-in-action*? With this understanding, you may then:
  1. Identify your feelings and intuitions that are emphasized in the situation
  2. Identify your deepest values that are in conflict in the situation
  3. Consider the feeling and intuitions of the other(s) in the situation
  4. Identify what their values and ethics are and how these might affect the conflict in the situation
  5. Identify the best course of action to understand the right thing to do for you and the others
- **In work groups**, managers can ask, "**Who are we?**" (Again, consider each team member's cultural values as well as your own, and ask how the team reflects any particular set of values. Identify the *ethical principles-in-action* of the team). You can then address these three questions as a team in this situation:
  1. What strong views and understanding of the situation do team members have—cross-culturally and within our own team?
  2. Which position or view would most likely win over others in a way that would be least harmful culturally and organizationally to all affected?
  3. Can we respond in this situation in a way that reveals the values we care about in this organization?
- **Company executives** can ask, "**Who is the company?**" (What are its core values and *ethical principles-in-action* in this international context and global setting?) Three questions you can consider are:
  1. Have I strengthened my position and the organization to the best of my ability relying on my values and ethics?

2. Have I considered my organization's values and role vis-à-vis the society's (both my society's, and another's, if abroad) cultural values and interests in a bold and creative way?
3. How can I transform my vision based on these reflections into action that combines creativity, ethical responsibility, courage, and shrewdness?

As discussed in Chapter 3, these ways of reflecting on the contextual values and facts in a situation when a difficult decision must be made is not always easy, especially in a cross-national setting. Deciding between two or more positions that are culturally and even morally "right" for parties in conflict also requires moral courage, common sense, and shrewdness. Section 8.6 offers specific methods of negotiating conflicting values cross-culturally. Next, we discuss some ethical issues in business that professionals may encounter when working across national boundaries.

## **Cross-Cultural Business Ethical Issues Professionals May Experience**

Some of the more predominant ethical issues that managers and professionals in international settings have experienced include (1) bribery and gifts, (2) sexual and racial discrimination, (3) piracy and intellectual property protection. These are a sample of such issues. The cases in the book present additional issues.

### **Bribery: A Form of Corruption**

"A former senior manager at Siemens yesterday [May 26, 2008] admitted building up an elaborate system of slush funds and shell firms at the request of his superiors to help Europe's biggest technology group win overseas contracts through bribes. Reinhard Siekaczek told a Munich court that he had informed his entire divisional board about the system and assumed that the whole group executive board knew about it from at least 2004. On the opening day of Germany's biggest post-war corporate corruption trial, Siekaczek described how managers signed off 'commissions' on yellow Post-It notes which could be easily removed in case of raids or investigations. His damning testimony included allegations that his efforts to stop the widespread bribery at Siemens' fixed-line telecommunications equipment division (Com), where he was a sales manager, had fallen foul of his superiors who 'didn't want to hear'. Siekaczek, aged 57, is the first of up to 300 accused among Siemens' current and former staff to stand trial in a corruption scandal that the group itself admits involves at least €1.3bn (£1bn) in siphoned-off money. Six of its divisions are involved in a bribery system spanning the globe that has so far cost it €1.8bn to clear up, including a €201m fine from another Munich court. It could result in a multibillion-dollar penalty from the US securities and exchange commission as well as the loss of lucrative contracts."<sup>32</sup>

Bribery can be a serious matter as the excerpt above shows. Bribery payments are estimated at \$1 trillion worldwide.<sup>33</sup> Leaders' and professionals' careers can be lost, settlements and court costs can be substantial to companies, and reputations tarnished. Bribery is part of the definition of corruption ("Corruption: moral perversion, depravity, perversion of integrity, bribery, corrupt or dishonest proceedings, any corrupting influence or agency.

Bribery: money or other valuable consideration given or promised with a view to corrupting the behavior of a person, a public official crime in some countries and not others”).<sup>34</sup> Bribery is a global problem: “Bribery in developing countries often stems from multinationals based in the richest countries. Global financial centers play a role in allowing officials to move, hide and invest illicitly gained wealth. Principles and ethics vary between countries. Interestingly, the U.S. accepts domestic political or legislative influencing practices such as lobbying and campaign funding, while considering the same underlying activities corrupt in other countries. The responsibility to combat corruption is global and no country can hold itself above the solution.”<sup>35</sup>

The organization *Transparency International* publishes a Buyers Payers Bribery Index. The report shows a ranked list of the top thirty countries on bribery (note: China and India ranked last, not shown on this short list):

**Rank/Country/Average Score (0–10)**

1. Switzerland	7.81	9. Belgium	7.22
2. Sweden	7.62	10. U.S.	7.22
3. Australia	7.59	11. Japan	7.10
4. Austria	7.50	12. Singapore	6.78
5. Canada	7.46	13. Spain	6.63
6. UK	7.39	14. UAE	6.62
7. Germany	7.34	15. France	6.50
8. Netherlands	7.28		

**SOURCE:** Transparency International (October 4, 2006), Buyers Payers Index, [http://www.transparency.org/policy\\_research/surveys\\_indices/bpi/bpi\\_2006](http://www.transparency.org/policy_research/surveys_indices/bpi/bpi_2006).

International organizations that have addressed and ratified bribery in different countries’ legislation include: the Organization for Economic and Cooperative Development (OECD), the Organization of American States (OAS), and the Council of Europe (CoE).

In the United States the FCPA (Foreign Corrupt Practices Act) was enacted in 1977 and substantially revised in 1988. The provisions of the FCPA prohibit the bribery of foreign government officials by U.S. persons and prescribe accounting and record-keeping practices that prohibit American companies from offering payments to foreign government officials for the purpose of obtaining or retaining business. “The fact that the FCPA deals only with bribes made to foreign government officials acts to exclude from the FCPA. . . payments to foreign persons who are not governmental officials. Additionally, the fact that the FCPA deals only with bribes that are intended for the purpose of obtaining or retaining business acts excludes grease or facilitating

payments from the scope of the FCPA. A grease or facilitating payment is a payment made to expedite or secure the performance of a routine government action. Routine government actions include obtaining permits or licenses, processing official papers, clearing goods through Customs, loading and unloading cargo and providing police protection.”<sup>36</sup> U.S. individuals who cannot defend their actions with regards to the FCPA’s anti-bribery provisions can face harsh penalties. “U.S. companies can be fined up to \$2 million while U.S. individuals (including officers and directors of companies that have willfully violated the FCPA) can be fined up to \$100,000 and imprisoned for up to five years, or both. In addition, civil penalties may be imposed.”<sup>37</sup>

Recently, the U.S. Department of Justice (DOJ) and SEC (Securities and Exchange Commission) have been more aggressive in enforcing and prosecuting the bribery section of the FCPA. Note the following example:

In December 2007, Lucent agreed to settle parallel DOJ and SEC FCPA enforcement actions by paying \$2.5 million in combined fines and penalties for improperly recording travel expenses and other things of value to employees of Chinese companies that were owned or controlled by the state (SOEs). Such individuals are deemed to be “foreign officials” under the FCPA’s anti-bribery provisions.

Pursuant to a DOJ non-prosecution agreement, Lucent acknowledged that from at least 2000 to 2003, it spent over \$10 million on approximately 315 trips involving over 1,000 employees of Chinese SOEs that had a disproportionate amount of sightseeing, entertainment, and leisure. According to the government, while the trips Lucent paid for were “ostensibly designed to allow the Chinese foreign officials to inspect Lucent’s factories and to train the officials in using Lucent’s equipment . . . the officials spent little or no time in the United States visiting Lucent’s facilities [but instead] visited tourist destinations throughout the United States, such as Hawaii, Las Vegas, the Grand Canyon, Niagara Falls, Disney World, Universal Studios, and New York.”<sup>38</sup>

Also, the FCPA’s penalties and levied fines have significantly grown in size. “In February 2007, the DOJ imposed a \$26 million criminal fine on three subsidiaries of Vetco International, Inc., then the largest criminal penalty the DOJ had ever sought in an FCPA action. Two months later, subsidiaries of Baker Hughes, Inc. were levied a combined penalty/fine of \$44 million. . . In addition to financial penalties, there is also a clear trend toward requiring offending firms to retain outside compliance consultants. Half a dozen cases that concluded in 2007 included such a provision, often mandating the consultant for a period of three years.”<sup>39</sup>

When doing business in developing countries where corruption, and particularly bribery, is prevalent, it is worth taking the following precautions:

- Read and understand the legislation and its enforcement on corruption and bribery in that country.
- Read and understand the U.S. Foreign Corrupt Practices Act and the OECD convention guidelines on corruption.
- Know your business associates and partners where you do business.
- Take an active role in education, compliance and due diligence.<sup>40</sup>



**Gifts vs. Bribery** A key question for new and even seasoned international business professionals is, “When is a gift really a bribe?” Peter Madsen, executive director of the Center for the Advancement of Applied Ethics and Political Philosophy at Carnegie Mellon University in Pittsburgh stated that “Hard and fast rules, however, tend to get blurry in international business settings. Even Fortune 500 companies with laudably firm policies have trouble in this area. . . . Relativism is rampant . . . and when you’re talking business, cultural relativism becomes a really big problem.”<sup>41</sup>

In most parts of the world, especially some less-developed nations, Asia, the Middle East, parts of Europe and the U.S., business professionals are expected to “pay to play.” Narayan Manandhar, former president of Transparency International in Nigeria, offers a distinction:

“Personally, I like to see the bribe located at an intermediate position in a continuum where at one extreme you can put extortion and at the other, a gift. A bribe becomes extortion when it is demand-driven. If a medical doctor asks for a bribe inside an operation theater or an emergency room, it is clearly a matter of extortion. You have been blackmailed to pay the bribe. A bribe could turn into a gift, if it is supply-driven. People have asked me whether tips paid to a waiter in a restaurant are a bribe or a gift. Normally, it is not a bribe. It is a gift as there is an element of voluntariness or the absence of a quid pro quo situation.”<sup>42</sup>

The OECD (2003) has an acronym for GIFT to mean “(1) Genuine, (2) Independent, (3) Free, and (4) Transparent. First, the gift must be genuine, that is, offered in appreciation for something which you have done well, in accordance with your functions as a public official, without any encouragement. Second, the gift must be independent in a sense that it does not affect your functioning in the future. Third, it must be free from any obligations to the donor, or for his/her family or affiliates. Fourth, it must be transparent. You must be able to declare the gift in a completely transparent way, to your organization and its clients, to your professional colleagues, and to the media and the public in general.”<sup>43</sup>

**Racial and Sexual Discrimination in the Global Context** Another area in which professionals working globally are likely to experience ethical issues is racial and sexual discrimination. While this issue and sexual harassment were discussed in Chapter 6, here we expand these topics to cross-cultural settings. “Racial discrimination is an attack on the very notion of universal human rights which should be enjoyed without distinction as to race, sex, language, ethnic origin, nationality or religion. Under international human rights law, states are obliged to combat discrimination in all its forms,” according to Amnesty International.<sup>44</sup> Globalization, the widening gap between income groups, the “global war on terror,” and the post-9/11 environment have created opportunities and problems with regard to unintended consequences regarding racial discrimination. A brief sample of countries that have immigrant populations illustrates the potential for and experience with racial discrimination. The U.S. continues to deal with the need for labor while wrestling with “illegal immigration” from Mexico; England has one of the most diverse working populations in the world, with East Indian immigrants representing a large

segment of that population; Germany must deal with integrating Turkish workers and immigrants; Dubai, the UAE, and Saudi Arabia all import labor—of the 1.5 million residents of Dubai, one million are immigrants; “Argentina’s population is 97 percent white (mostly of Spanish and Italian descent) and three percent mestizo (Amerindian and European). One of the difficulties in assessing and addressing persistent forms of racial discrimination in Argentina is the lack of adequate information about the population, particularly the indigenous and immigrant communities.”<sup>45</sup> Racial discrimination doesn’t only occur between native residents and immigrants of host countries. As noted above, discrimination is practiced in different forms including in MNCs as well as with an international labor force. Also racial discrimination here refers to the workplace and generally involves acts relating to hiring, wage inequalities, treatment of employees, working conditions, and promotions.

A recent world survey on workplace discrimination shows the disparity in opinions about racial discrimination but also calls on governments to act to prevent such acts:<sup>46</sup>

- Majorities in 15 out of 16 nations [polled] agree that employers do not have the right to discriminate. Asked whether employers should be allowed to “refuse to hire a qualified person because of the person’s race or ethnicity,” on average three out of four (75%) say employers should not be able to base hiring decisions on race, while just 19% believe they should.
- Majorities against workplace discrimination are largest in France (94%), China (88%), the United States (86%), Indonesia (84%), Britain (83%), and Azerbaijan (82%).
- Again, India stands apart from the other countries polled. Although a plurality opposed such discrimination, an unusually high 30% says that employers should be allowed to reject jobseekers because of race or ethnicity. Relatively large minorities also agree that employers should be free to hire whom they choose in Nigeria (34%) and South Korea (41%), though in both cases, majorities are opposed (64% and 58%, respectively).
- Indonesians (80%) and the Chinese (77%) believe overwhelmingly that the government should try to prevent discriminatory hiring practices, followed by Azerbaijanis (72%), the French (69%), Americans (69%), Britons (69%), Ukrainians (65%), Mexicans (64%), and Iranians (61%). More modest majorities agree in Russia (58%), Egypt (56%), Nigeria (56%), the Palestinian territories (53%), and South Korea (53%).
- Two countries differ: Turkey and India. Only 23% of Turks say that the government has the responsibility to take measures against workplace discrimination and 43% say it does not. Among Indians just 27% say that government has this responsibility, while 20% say it does not.

Companies hiring and integrating employees into their firms benefit from having corporate leaders and cultures that do not tolerate racial discrimination. Lack of respect and fairness from employers in their hiring, promotion,

and reward practices leads to employee turnover, absenteeism, and lower performance. Employees usually turn first to their supervisors in the chain of command to report or discuss discrimination problems. If the company has no formal or written policy, the employee must decide whether or not to pursue the issue to others in the organization or go outside. Corporations can benefit from establishing such policies and procedures along with training to support their workforce.

The United Nations Human Rights Council moved to establish a new subsidiary body, the “Expert Mechanism on the Rights of Indigenous Peoples” on December 13, 2007. Other United Nations agencies, NGOs (non-governmental organizations), and different countries’ human rights groups, such as The European Commission against Racism and Intolerance (ECRI) which was established by the first Summit of Heads of State and Government of the Council of Europe Member States, all continue to implement policies, help create laws, and monitor racial discrimination not only in workplaces but also in different societies. Companies moving to different countries and those already serving different countries need to familiarize their officers and professionals with the work of these UN bodies and NGOs. Many large, established MNEs have partnered and worked with such bodies for decades.

**Sexual Discrimination** Sexual discrimination is generally part of laws dealing with other types of discrimination and rights such as race, age, national origin, gender, religion, and language. Not all countries have laws or even policies dealing with sexual harassment and/or discrimination specifically against women, or men. In a cross-national survey published in 2000, and cited in Chapter 6, France, Germany, Mexico, the Philippines, Switzerland, Taiwan, and Venezuela had no “prohibitions on employment discrimination.” Several countries also had no “prohibitions on sexual harassment” in the workplace—Ukraine, Singapore, Russia, Republic of South Africa, Poland, China, Hungary, Czech Republic, Colombia, and Brazil. Note that “In Europe, there is an increasing focus on behaviors described as ‘moral harassment,’ ‘mobbing,’ or ‘workplace bullying,’ all of which subordinate concern about the integration of women in the workforce to concern about the rights of all workers.”<sup>47</sup>

Companies working globally that follow universal principles and values will adopt sexual harassment and discrimination policies and be clear that women are included in such policies. Since leadership and professional talent in many regions of the world is at record shortages, companies cannot afford to exclude the protection of competent women leaders and professionals from these policies:

Laws that protect workers from sexual harassment conceive of sexual harassment in a number of different ways: as discrimination based on sex, as an offense against dignity, or as an issue of health and safety in the workplace. The discrimination conception of sexual harassment law reflects an understanding that such law is designed to protect a vulnerable group—in this case mainly women—that is the target of inappropriate sexual behavior in the workplace. From this viewpoint, laws prohibiting sexual harassment must be implemented so as to remove an obstacle to the integration of women in

the workforce. . . Many countries have adopted the anti-discrimination model of sexual harassment law in an attempt to protect the rights of women in the workplace.<sup>48</sup>

**Piracy and Intellectual Property Protection** Intellectual property is best defined in the context of a quote from a U.S. Trade Representative: “Innovation is the lifeblood of a dynamic economy here in the United States, and around the world. We must defend ideas, inventions and creativity from rip off artists and thieves.”<sup>49</sup> When any materials or products are patented, trademarked, and copyrighted in the U.S. or other countries, these items are assumed to be protected under law. Brands are valuable commodities. When imitated, copied, and abused the owners and originators of the brand are harmed.

Intellectual Property(IP) theft is estimated at \$250 billion annually, costing the United States about 750,000 jobs, according to the U.S. Commerce Department. The International Chamber of Commerce estimates the global fiscal loss of IP at over \$600 billion a year.<sup>50</sup>

However, as we discussed in the opening case in the first chapter, illegal file sharing of music has been facilitated by the Internet and has become a practice of global piracy. That debate is ongoing. However, when countries protect or do not punish piracy of intellectual property, the issue moves to a different level and can involve government-to-government and global issues. For example:

Violations of intellectual property rights (IPR) continue to plague world markets and pose a major challenge to innovators and artists worldwide despite clear improvements by several U.S. trading partners, according to a new U.S. government report. In the report, released April 30, 2007, the Office of the U.S. Trade Representative (USTR) placed 12 countries on its “priority watch list” for failing to protect adequately producers of copyrighted, patented and trademarked materials, such as movies, music and pharmaceuticals.<sup>51</sup>

China, Russia, Argentina, Chile, Egypt, India, Israel, Lebanon, Thailand, Turkey, Ukraine, and Venezuela are countries on the priority list that is monitored by the U.S. for intellectual piracy. Bahamas, Bulgaria, Croatia, the European Union, and Latvia have been removed from the watch list. Intellectual piracy between countries is also viewed in the context of trading agreements and how countries adopt stricter laws to prevent, decrease and stop observed violations.

Gupta and Wang (2007) take a more entrepreneurial view of intellectual property piracy. They state that even if over 80% of the software and music consumed in China and India is pirated, the estimated piracy rates in the U.S. are at about 30%. Also the governments of China and India are becoming serious about laws enforcing intellectual property and that their motivation is to accelerate each country’s science and technology base. The authors note that “Instead of obsessing about these issues, companies should aim for a rapid rate of innovation that makes life difficult for imitators and pirates in developed and developing countries alike. Rapid innovation may not reduce piracy, but it will help ensure that pirates’ products are viewed as consistently inferior, and thus less desirable.” Their logic

also states that “Companies can also reduce piracy by making their products or services more affordable. This is what Microsoft is now attempting with the introduction of Windows XP Starter Edition, a no-frills and low-priced version of its operating system for India, Brazil and many other emerging markets.” So U.S. and other country firms should reduce intellectual-property leakage “by dispersing R&D and production across China, India and other locations.”<sup>52</sup>

Companies operating in other countries where intellectual property violations are prevalent need to have clearly stated policies and procedures that are communicated and supported with training to those employees who are responsible for handling these issues with the firm’s stakeholders.

### 8.3 SOCIETAL ISSUES AND GLOBALIZATION: THE DARK SIDE

At a larger societal level, it is difficult to determine whether the process of globalization is the cause or effect of the forces driving this phenomenon. Certainly governments, multinational and transnational corporations effect this process, but they too are influenced by the forces driving the changes. In this section, we discuss some of the broader “dark side” issues of globalization before discussing the role of multinationals. The process of globalization may be producing “losers” i.e., countries that cannot share in the wealth- and health-generating processes, activities, and outcomes of globalization because they are either excluded from or ignored with respect to the positive side of globalization—for example, technology development and use, education, and economic development. However, many of the issues discussed here are being addressed by United Nations agencies, NGOs (non-governmental agencies), and country governments. Corporations and strategic alliances are attacking problems with the natural environment, as discussed in previous chapters.

Critics generally argue that globalization has caused, or at least enhanced, the following problems: crime and corruption; drug consumption; pollution of the environment; massive layoffs that occur when companies move to regions that offer cheaper labor; decreases in wages; the erosion of individual nations’ sovereignty; and the Westernization (led by Americanization) of culture, standards, and trends in entertainment, fashion, food, technology, ways of living, and values. These are not all of the issues related and attributed to globalization, but they are substantial ones that also affect economies and populations of the world which comprise the environments in which businesses operate.

#### Crime and Corruption

“In Eastern Europe, traffickers ship girls through the Balkans and into sex slavery. Russians launder money through tiny Pacific islands that have hundreds of banks but scarcely any roads. Colombian drug barons accumulate

such vast resources that they can acquire a Soviet submarine to ship cocaine to the United States. . . . [I]t is clear that the globalization of crime is a logical outcome of the fall of Communism. Capitalism and Communism, ideologies that served as intellectual straitjackets for Americans and Soviets, allowed them to feel justified in unsavory proxies to fight their cold war.”<sup>53</sup> The Global Trends 2015 Report estimates that corruption costs \$500 billion annually, 1% of the global economy. The report also stated that in the illegitimate economy, narcotics trafficking has projected annual revenues of \$100 to \$300 billion. Auto theft in Europe and the United States is estimated to net \$9 billion, and the sex slave business projects \$7 billion. Every third cigarette exported is sold on the black market.<sup>54</sup> The Corruption Perception Index—based on the perceptions of ordinary citizens, business leaders, and experts and developed by the nonprofit group Transparency International—shows that the most corrupt countries in 2007 were Somalia, Iraq, Haiti, Tonga, Uzbekistan, Chad, Sudan, and Afghanistan. The United States ranked toward the bottom of the top 20 least corrupt countries. See Figure 8.4 for recent survey results of the global country corruption index. Interesting to note that some of the industrialist leading nations did not rank at the top for non-corrupt activities.

Figure 8.4

### The 2007 Corruption Perception Index\*

Least Corrupt			Most Corrupt		
Rank	Country	Score	Rank	Country	Score
1	New Zealand	9.4	162	Bangladesh	2.0
2	Denmark	9.4	163	Papua New Guinea	2.0
3	Finland	9.4	164	Turkmenistan	2.0
4	Singapore	9.3	165	Central African Republic	2.0
5	Sweden	9.3			
6	Iceland	9.2	166	Cambodia	2.0
7	Netherlands	9.0	167	Venezuela	2.0
8	Switzerland	9.0	168	Laos	1.9
9	Norway	8.7	169	Guinea	1.9
10	Canada	8.7	170	Congo, Democratic Republic	1.9
11	Australia	8.6			
12	Luxembourg	8.4	172	Afghanistan	1.8
13	United Kingdom	8.4	173	Sudan	1.8
14	Hong Kong	8.3	174	Chad	1.8
15	Austria	8.1	175	Uzbekistan	1.7
16	Germany	7.8	176	Tonga	1.7
17	Japan	7.5	177	Haiti	1.6
18	Ireland	7.5	178	Iraq	1.5
19	France	7.3	179	Somalia	1.4
20	USA	7.2			

\*179 countries ranked 1 = most corrupt, 10 = least corrupt

**SOURCE:** “Transparency International Corruption Perceptions Index 2007,” <https://owa.bentley.edu/Exchange/JWEISS>, accessed July 6, 2008.

## Economic Poverty and Child Slave Labor

“According to the Fisek Institute Science & Actions Foundation for Child Labor:

There are 1.5 billion children living in the world who are in the age range of 5-17, according to the official numbers. Among them 317 million are engaged in economic activity while 217 million are considered child workers. 126 million child workers fall in the category of ‘Hazardous Labor’ and 8 million children fall into the category of ‘Worst Forms of Child Labor’ which means they act in prostitution, sell drugs, become a part of crime rings, are involved in armed conflict, perform in pornography and get trafficked.”<sup>55</sup> Other facts: “More than 120 million children between 5 and 14 years old work full-time. Include children whose work is a secondary activity and the number climbs to 250 million.”<sup>56</sup> Child labor exists in both developing and industrialized countries, but mostly in South and Southeast Asia, South America, Africa, and increasingly in Eastern Europe where there is an economic transition from a command economy to a market economy.<sup>57</sup> “Among countries, the big losers are in Africa, south of the Sahara. They are not losing, however, because they are being crushed by globalization. . . . [T]hey are losing because they are being ignored by globalization. They are not in the global economy. No one in the global business community wants anything to do with countries where illiteracy is high, where modern infrastructure (telecommunications, reliable electrical power) does not exist, and where social chaos reigns. Such countries are neither potential markets nor potential production bases.”<sup>58</sup> The gap in per capita GDP between the richest and poorest countries in the world is about 140:1. This gap will increase as the shift from industrial- to knowledge-based economies continues to occur. “Any Third World country that wants the benefits of globalization has to get itself organized to acquire those technologies.”<sup>59</sup>

Regions of the Ivory Coast of Africa (e.g., Logbogba, Sinfra, Soubre) continue to attract child labor traffickers (those who buy, enslave, and sell children to work on industrial projects and plantations, like cocoa and chocolate production). Annual wages paid for children under the age of 14 are about U.S. \$135 to U.S. \$165. Poverty is dire in this region. A broad UNICEF estimate is that there are 200,000 children worldwide who are victims of traffickers every year. Ivory Coast law permits children over 14 to work if the work is not dangerous and they have parental consent.<sup>60</sup>

The Third World includes not only all of sub-Saharan Africa, but also large parts of the Middle East and much of South Asia and Central and South America. “Hunger is common; disease is rampant; infant mortality is high; life expectancy is short.”<sup>61</sup> Notable economists from the Group of Eight (leading industrial countries) conclude that solutions to Third World poverty must include “. . . systematic attempts to change incentives at every level in the global system—from the gangsterish Third World governments that exploit their citizens to the international institutions that prop them up through continued lending.”<sup>62</sup>



## The Global Digital Divide

“The Universal Declaration of Human Rights and Article 19 of the International Covenant on Civil and Political Rights (ICCPR) proclaim the freedom of everyone without discrimination to enjoy access to information. The majority of countries have ratified and accepted the duty to guarantee this freedom by signing the ICCPR.<sup>63</sup> Freedom of expression as a right includes freedom to seek, receive, and impart information and ideas of all kinds, regardless of frontiers, either orally, in writing or in print, in the form of art, or through any other media of his or her choice.”<sup>64</sup>

The research conducted by Philip Howard, assistant professor of communications at UW, found that “. . . even when more computers are produced than ever before, more are concentrated in rich, developed countries than 10 years ago. But Internet access in developing countries means paying more and getting less. It costs the average person in New York or London about 6 percent of their daily income for an hour of Internet access at a cybercafé, while people in Lagos, Nigeria spend about 75 percent. By contrast, those in developing nations are less likely to find news and other content from within their countries, the research found. According to the United Nations, more than 80 percent of people in the world have never heard a dial tone, let alone surfed the Web.”<sup>65</sup>

Ventures are under way to provide poorer children with computers. Negoponte at MIT started the non-profit One Laptop Per Child (OLPC) organization that was set up to develop and market a low-cost, under \$100, education-focused laptop for the poorest children across the globe. Another venture is Bill Gates’ Microsoft research lab in India, where he is focusing on projects that provide “. . . low-cost wireless to new computing interfaces that will allow semi-literate and illiterate people to use computers effectively.”<sup>66</sup> Still, one third of the world’s population is disconnected from and has no access to the Internet. This fact continues to broaden the divide between the haves and the have-nots and between the First and Third World countries. Less than 1% of online users live in Africa. Less than 5% of computers are connected to the Internet in developing countries. The developed world has almost 50 phone lines for every 100 people, compared to 1.4 phones per 100 people in low-income countries. Countries excluded from the global economy are those that cannot and do not build access to the Internet. Wireless technologies offer encouraging signs for Third World country access to First World technologies.<sup>67</sup> The EU has committed to concentrate its efforts on formulating information on society policies focusing on EU coordination, Internet governance, and financing.<sup>68</sup> The U.S., technology multinationals, and other regional alliances are also working to fund and supply less-advantaged countries with Internet capabilities.<sup>69</sup>

## Westernization (Americanization) of Cultures

Globalization has brought “Americanization” (some critics say imperialism) to other cultures through fast-food commerce (McDonald’s, the *Fast Food Nation* phenomenon discussed in Chapter 4). The “McDonaldization of



Society,”<sup>70</sup> as noted earlier, in Chapter 5, is “the process by which the principles of the fast-food restaurant are coming to dominate more and more sectors of American society as well as the rest of the world.”<sup>71</sup> George Ritzer, the author of the book *The McDonaldization of Society*, argues that “McDonaldization affects not only the restaurant business but also education, work, the criminal justice system, health care, travel, leisure, dieting, politics, the family, religion, and virtually every other aspect of society.”<sup>72</sup> (Ritzer states toward the end of his book that “McDonaldization will someday pass on when the nature of society has changed so dramatically that they can no longer adapt to it.”<sup>73</sup>)

In addition to fast food, the Internet has brought instant exposure to all forms of American culture: entertainment, films, news, music, and art. Values and ways of living underlie these influences and are not always welcome in many countries—France, China, Singapore, and countries in the Middle East to name a few. Serious ethical questions are asked that are related to problems and threats of globalization through Westernization: “Does globalization result in cultural and economic homogenization through a heightened emphasis on consumerism? Do local and global values change as a result of international integration that promotes the conversion of national economies into environmentally and socially harmful export-oriented systems for competition in geographically and culturally transcendent ‘world markets’?”<sup>74</sup>

American-based advertising to children, in particular, also has come under criticism in the U.S. Juliet Schor’s book, *Born to Buy* (2004), examines American contemporary culture in which advertising significantly affects children aged eighteen months through thirteen years old. Schor’s research shows that children shopped “50% more than the preceding generation, both with their parents and on their own. The supermarket was the predominant consumer arena. . . . commodities have become increasingly influential especially in social dynamics within schools.”<sup>75</sup>

Children’s advertising also affects foods children eat, clothes they buy, product brands they know and select when shopping, advice on relationships with parents and friends, and programs to watch on TV and films. According to Schor (2004), one remedy of this process would be the “. . . de-commercialization of food, media space, and the outdoors.” She advocates for a “. . . national comprehensive curriculum in gardening, menu planning, eco-literacy, and science and nutrition.”<sup>76</sup> The point here is that American advertising—like entertainment, media, and films—is becoming another export that carries habits and a way of life that other cultures may find unacceptable.

## Loss of Nation-State Sovereignty

Critics also protest that globalization erodes the ability of governments to protect the interests of their citizens against more powerful multinational corporations. At conflict are the benefits of economic globalization and the laws and institutions within these nations’ own boundaries. Part of the debate centers on the argument that market forces are global and must be dealt with by global businesses.

There is also tension over sovereignty between nations and multinationals regarding power and influence. An example was the rejection of the proposed merger between General Electric and Honeywell by the European Commission's antitrust authorities. That merger, it was argued, would have left public interest behind, because these companies bring different legal and regulatory traditions across the Atlantic. Questions raised included: "What right does the European Commission have telling two American companies what they can and cannot do . . . especially when its decision conflicts with the decision reached by the relevant American authority? Sure, [the United States] supports the rule of law, but whose law? Aren't [U.S.] antitrust laws, which reflect our strong market tradition, superior to Europe's, which tend to reflect a strong statist tradition?"<sup>77</sup> On the other hand, Microsoft's fine by the EU on monopoly charges indicates that the global environment is a playing level where international law applies.<sup>78</sup>

Loss of nation-state arguments diminish when evidence is provided that multinationals cannot, and do not claim to, protect citizens during wars and regional conflicts; collect taxes; distribute benefits; build roads and infrastructure; care for the environment; or protect the rights of individuals, groups, and the elderly. In fact, governments subsidize and support companies when needed. In the immediate aftermath of the terrorist attack on the World Trade Center, the U.S. airlines suffered sizable financial losses. It is estimated that 2007–2008 losses in the industry will be \$6.1 billion.<sup>79</sup>

Other industries (e.g., railroad, automobile, agribusiness, aerospace) have also been subsidized by government funds. Still, it is argued that "globalization will continue to chip away at the power of the nation state. As the Europeans know from their experience over the last 50 years, surrendering some degree of national autonomy is a natural and inevitable concomitant of growing economic interdependence."<sup>80</sup> The degree to which nation-states share and/or give up power, influence, and sovereignty to global companies—and the types of power, influence, and sovereignty they do give up or share—is and will be a continuing subject of debate.

## 8.4 MULTINATIONAL ENTERPRISES AS STAKEHOLDERS

An MNC (multinational corporation) or TNC (transnational corporation) is generally regarded as "an enterprise comprising entities in more than one country which operate under a system of decision-making that permits coherent policies and a common strategy. The entities are so linked, by ownership or otherwise, that one or more of them may be able to exercise a significant influence over the others and, in particular, to share knowledge, resources and responsibilities with the others."<sup>81</sup> MNEs and TNCs are corporations that "own or control production or service facilities outside the country in which they are based."<sup>82</sup> Companies go global to enhance profit by creating value, building and increasing markets, and reducing costs. Costs are reduced by locating and using raw materials, skilled labor, land, and taxes at lower costs. Value can also be added by joint venturing with

other national and regional partners who have market reach, global skills, experience, and resources.

The Bureau of Economic Analysis (BEA) data indicates that “. . . as of 2005, more than 70 percent of worldwide production by MNCs occurs in the United States. Of the 28 percent of production that occurs abroad, over 80 percent occurs in other high-income countries. . . Although the global allocation of MNC production has shifted moderately toward lower income countries in recent decades, the production that occurs in those countries is overwhelmingly directed toward the local market rather than being part of an international production network. In China and India, for example, sales to local customers account for nearly three-quarters of total sales by affiliates of U.S. MNCs. Therefore, if MNCs are not primarily locating foreign operations in low-wage countries, there must be attributes of host countries other than wages that influence their location decisions.”<sup>83</sup>

## Power of Multinational Enterprises

Although MNEs often reflect and extend their home nation’s culture and resources, many are powerful enough to act as independent nations. This section focuses on MNEs as independent, powerful stakeholders, using their power across national boundaries to gain comparative advantages, with or without the support of their home country. The following facts indicate the power of MNEs:

- Worldwide employment by U.S. MNCs increased 3.3 percent in 2006, to 31.3 million workers. Employment in the United States by U.S. parent companies increased 2.7 percent, to 21.9 million workers, following a 0.8 percent increase. The employment by U.S. parents accounted for almost one-fifth of total U.S. employment in private industries. Employment abroad by the majority-owned foreign affiliates of U.S. MNCs increased 4.7 percent, to 9.4 million workers, following a 3.0 percent increase.
- Worldwide capital expenditures by U.S. MNCs increased 17.8 percent in 2006, to \$547.6 billion. Capital expenditures in the United States by U.S. parents increased 16.5 percent, to \$394.2 billion, following an increase of 9.0 percent. Capital expenditures abroad by majority-owned foreign affiliates increased 21.3 percent, to \$153.4 billion, following a 2.4 percent increase.
- Sales by U.S. parent companies increased 7.5 percent in 2006, to \$8,283.7 billion, following a 9.1 percent increase in 2005. Sales by majority-owned foreign affiliates increased 10.3 percent, to \$4,113.9 billion, following a 12.6 percent increase.

The world’s largest companies are shown in Figure 8.5. They include Wal-Mart, Exxon, Royal Dutch/Shell group British petroleum (UK), Toyota, Chevron, Ford Motor Company, Daimler Chrysler, Toyota, General Electric, and Total. Of the 500 largest corporations, 153 are U.S. firms, 64 are Japanese, and 39 are French.

The dominant goal of MNEs is, as noted earlier, to make a profit and take comparative advantage of marketing, trade, cost, investment, labor,

Figure 8.5

**World's Largest Companies**

Search Rank	Company	Revenues (\$ Millions)	Profits (\$ Millions)
1	Wal-Mart Stores	263,009.00	9,054.00
2	BP	232,571.00	10,267.00
3	ExxonMobil	222,883.00	21,510.00
4	Royal Dutch/Shell Group	201,728.00	12,496.00
5	General Motors	195,324.00	3,822.00
6	Ford Motor Company	164,505.00	495
7	DaimlerChrysler	156,602.20	507
8	Toyota Motors	153,111.00	10,288.10
9	General Electric	134,187.00	15,002.00
10	Total (French company)	118,441.40	7,950.60

**SOURCE:** Fortune.com/Global 500, "World's largest corporations." Also reference Hjelt, P. (July 26, 2004). The Fortune Global 500, *Fortune*, 179.

and other factors. At the same time, MNEs assist local economies in many ways, as will be explained. The ethical questions critics of MNEs have raised are partly reflected in the following statement by the late Raymond Vernon, noted Harvard professor and international business expert: "Is the multinational enterprise undermining the capacity of nations to work for the welfare of their people? Is the multinational enterprise being used by a dominant power as a means of penetrating and controlling the economies of other countries?"<sup>84</sup> The next subsection addresses these questions in a discussion of the mutual responsibilities and expectations of MNEs and their host countries.

**Misuses of MNE Power** Corporations cannot act as if they operate in a social vacuum. Society's values changed after September 11 and in order to maintain legitimacy, organizations were now expected to take into consideration a new social framework where society expected them to go beyond mere financial decisions and do "the right thing." This change is evident from the hundreds of shareholder resolutions, lodged in recent years, relating to social issues. It is also reflected in the new environment of corporate social responsibility and increased disclosure. The stream of corporate failures, the subprime lending crisis, and the fragility of the U.S. and global financial systems have led to critics questioning more closely the motives and many practices of MNEs and large corporations' management in general.<sup>85</sup> From an ethical perspective, we ask: Why are some MNEs not paying their fair share of taxes in countries where they are located? Why are MNEs pushing their costs of doing business on to taxpayers and the public? Why are MNEs not treating the environment as a public good instead of as a "negative externality"—i.e. as a "spill over" cost from businesses to third parties? Why are MNEs not treating and paying local labor better in less developing—and even some developed—countries? Why are some markets treated less equally and equitably—for example why do some

pharmaceuticals not put the same warning labels on drugs in poorer, less regulated markets as they do in more developed, richer countries? Why are children and women in some developing countries discriminated against in labor practices by some MNEs? Of course, not all MNEs violate international law or take advantage of less developed countries' markets and peoples; however, our interest here is discussing ways in which MNEs operate (and have operated) in host countries in order to explore more socially responsible practices.

Crises since the birth of the multinational corporation after World War II have raised international concern over the ethical conduct of MNEs in host and other countries. Not long ago, the Ford-Bridgestone/Firestone tire crisis was international in nature. These companies were not forthright early on with their consumers about defects known by the companies. Union Carbide's historic chemical spill disaster in Bhopal, India, resulted in thousands of deaths and injuries and alarmed other nations over the questionable safety standards and controls of MNE foreign operations. Nestlé's marketing of its powdered infant milk formula that resulted in the illness and death of a large number of infants in less developed countries raised questions about the lack of proper product instructions issued to indigent, less-educated consumers. (Nestlé's practice resulted in a boycott of the company from 1976 to 1984.) Also, the presence of MNEs in South Africa raised criticisms over the role of large corporations in actively supporting apartheid or government-supported racism. Because MNEs had to pay taxes to the South African government and because apartheid was a government-supported policy, MNEs—it is argued—supported racism. Several U.S.-based MNEs that operated in South Africa witnessed boycotts and disinvestments by many shareholders. Many MNEs, including IBM and Polaroid, later withdrew. Post-apartheid South Africa has seen the reentry of companies from all countries. Another long-standing moral issue is the practice of MNEs of not paying their fair share of taxes in countries where they do business and in their home countries. Through transfer pricing and other creative accounting techniques, many MNEs have shown paper losses, thereby enabling them to avoid paying any taxes.

Critics claim that many multinational corporations are not fulfilling their part of the implicit social contract discussed in Chapters 4 and 5. Some of these critics include Richard Barnett and John Cavanagh in their book *Global Dreams*, David Korten in *When Corporations Rule the World*, Tom Athanasiou in *Divided Planet: The Ecology of Rich and Poor*, Paul Hawken in *The Ecology of Commerce*, and William Greider in *One World, Ready or Not*.<sup>86</sup> Multinationals' practices subject to criticism include committing corporate crimes, exerting undue political influence and control, determining and controlling plant closings and layoffs, and damaging the physical environment and human health. Evidence regarding these claims showed, for example, that 11% of 1,043 MNEs studied were involved in one or more major crimes over a 10-year period. The crimes included foreign bribery, kickbacks, and improper payments. A small sample of those firms included Enron, WorldCom, Adelphia, American Cyanamid, Anheuser-Busch, Bethlehem Steel, Allied Chemical, Ashland Oil, and Beatrice Foods. Large corporations (along with trial lawyers and labor unions) also have

immense influence through political action committees (PACs). The organization Common Cause noted that the majority of soft money contributions to both American parties in 1999 came from corporate business interests. With regard to plant closings and “downsizings,” critics are concerned that some MNEs are more concerned with a particular profit margin than with their share of responsibility to community and society. After all, taxpayers support roads and other external conditions that allow corporations to operate in a country. Although corporations are not expected to be a welfare system for employees, critics note that large companies are expected to share in the social consequences of their actions, especially when, for example, plant-closing decisions are made to reap the benefits of cheaper labor in another country. Finally, there is historical evidence that several large corporations have harmed the physical environment and the health of their employees and local communities. Classic crises cases discussed in Chapter 5 regarding asbestos manufacturing, oil spills, chemical plant explosions, toxic dumping, and industrial air pollution demonstrate corporate misuses of the environment in recent history. The external and human costs that communities, governments, the environment, and taxpayers have had to pay for these misuses of power are documented.

In the following sections, two perspectives regarding global corporations’ responsibilities—that of the MNE and that of the host country—are discussed.

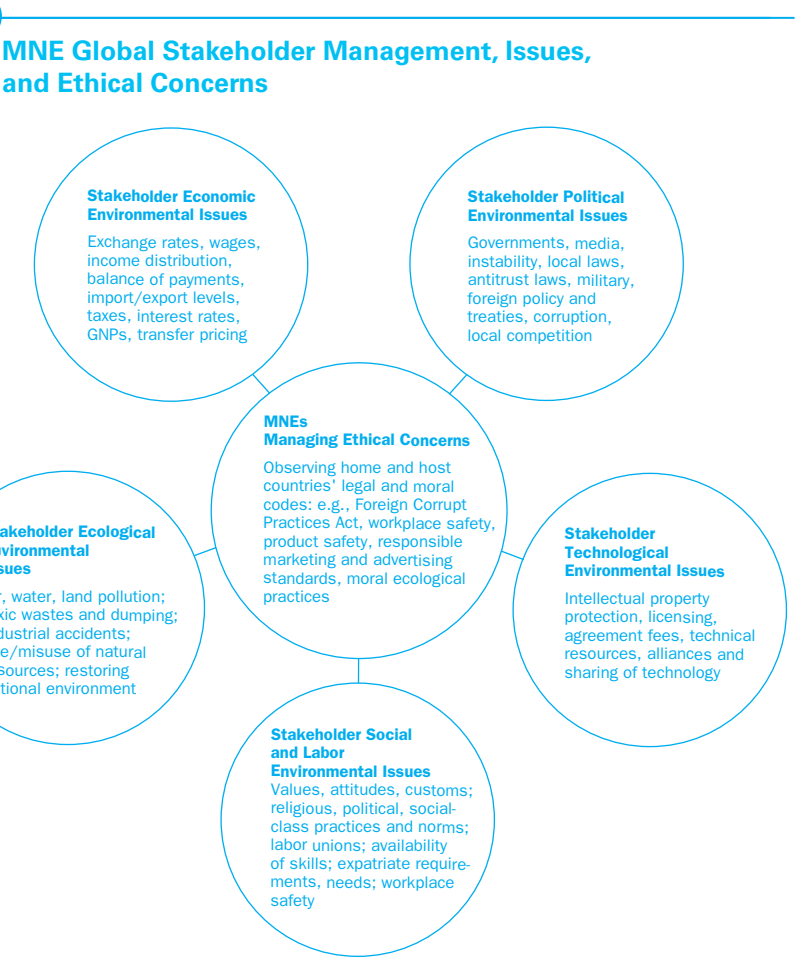
**MNE Perspective** “A rising tide lifts all ships.” MNEs enter foreign countries primarily to make profit, but they also create opportunities host countries would not have access to without these companies. Although MNEs benefit from international currency fluctuations, available labor at cheaper costs, tax and trade incentives, and the use of natural resources, and gain access to more foreign markets, these companies benefit their host countries through foreign direct investment and in these ways:

- Hire local labor
- Create new jobs
- Co-venture with local entrepreneurs and companies
- Attract local capital to projects
- Provide for and enhance technology transfer
- Develop particular industry sectors
- Provide business learning and skills
- Increase industrial output and productivity
- Help decrease the country’s debt and improve its balance of payments and standard of living

Moreover, MNEs open less-developed countries (LDCs) to international markets, thereby helping the local economy attract greatly desired hard currencies. Also, new technical and managerial skills are brought in, and local workers receive training and knowledge. Job and social-class mobility is provided to inhabitants.<sup>87</sup> Some MNEs also establish schools, colleges, and hospitals in their host countries. For example, although Nike has been criticized for its international child labor practices, it is also true that by contracting with factories abroad, it has helped employ more than half a

million workers in 55 countries. Eighty-three percent of Nike’s workforce in Indonesia is women who would not otherwise be employed.<sup>88</sup> Another company, Patagonia Inc., has given 1% of its annual sales to environmental groups and gives employees up to two paid months off to work for non-profit environmental groups. The company also routinely permits independent human rights organizations to audit any of its facilities. The company participates in the Apparel Industry Partnership (AIP) to set standards to expose and monitor inhumane business practices in their industry. Cadbury’s is another example of a company that has practiced high ethical standards abroad. In India, the company hired local workers and instilled new work-related ethical values in its plant.<sup>89</sup>

The MNE must manage overlapping and often conflicting multiple constituencies in its home- and host-country operations. Figure 8.6 illustrates some of the major environments and stakeholder issues the MNE must



SOURCE: Copyright © Joseph W. Weiss, Bentley College, Waltham, MA, 2009.

technically and ethically balance and manage in its foreign location. From the MNE's perspective, managing these stakeholder issues is difficult and challenging, especially as the global economy presents new problems.

MNE executives and other managers also complain of what they consider unethical practices and arbitrary control by host-country governments. For example, local governments can and sometimes do the following:

- Limit repatriation of MNE assets and earnings
- Pressure and require MNEs to buy component parts and other materials from local suppliers
- Require MNEs to use local nationals in upper-level management positions
- Require MNEs to produce and sell selected products in order to enter the country
- Limit imports and pressure exports
- Require a certain amount or percentage of profit to remain in or be invested in the country

Finally, MNEs always face the threat of expropriation or nationalization of their operations by the host government. More recently, MNEs must assume high-stakes risks, liabilities, and responsibilities in the area of safety, especially since September 11, 2001. The airline industry in particular has been hit very hard by this unpredictable crisis. The crisis itself, along with the “fallout” over laxness in safety standards and enforcement, has taken a heavy toll on all U.S. and most international carriers. The price of doing business safely has escalated.

**Host-Country Perspective** Six criticisms of the presence and practices of MNEs in host and other foreign locations are discussed here.

1. MNEs can dominate and protect their core technology and research and development, thus keeping the host country a consumer, not a partner or producer. The Brazilian government, for example, has counteracted this by having entry barriers and laws that, since the 1970s, have protected against the complete control of its own electronics industries by foreign manufacturers. It is also argued (or feared) that Japan's MNEs could in the long term dominate certain critical industries (such as the electronics industry and perhaps the automobile industry) in the United States and use American labor more as assemblers than as technology R&D partners.
2. MNEs can destabilize national sovereignty by limiting a country's access to critical capital and resources, thereby creating a host-country dependency on the MNE's governments and politics.
3. MNEs can create a “brain drain” by attracting scientists, expertise, and talent from the host country.
4. MNEs can create an imbalance of capital outflows over inflows. They produce but emphasize exports over imports in the host country, thereby leaving local economies dependent on foreign control.



5. MNEs can disturb local government economic planning and business practices by exerting control over the development and capitalization of a country's infrastructure. Also, by providing higher wages and better working conditions, MNEs influence and change a country's traditions, values, and customs. "Cultural imperialism" is imported through business practices.
6. MNEs can destroy, pollute, and endanger host-country and LDC environments and the health of local populations. For example, the mining of and dangerous exposure to asbestos continue in some LDCs and in Canada.

Obviously, these criticisms do not apply to all MNEs. These criticisms represent the concerns of host-country and LDC governments that have suffered abuses from multinationals over the decades. Tensions in the relationships between MNEs and host countries and other foreign governments will continue, especially in the least-developed settings. Whenever the stakes for both parties are high, so will be the pressures to negotiate the most profitable and equitable benefits for each stakeholder. Often, it is the less-educated, indigent inhabitants of LDCs who suffer the most from the operations of MNEs.

More global companies are beginning to self-monitor and contribute to host-country education, consumer awareness, and community programs (e.g., Shell has written a primer on human rights with Amnesty International; Hewlett-Packard offers consumer education programs and computer training in host countries).

## 8.5 TRIPLE BOTTOM LINE, SOCIAL ENTREPRENEURSHIP, AND MICROFINANCING

Positive trends in large and small businesses (globally and locally) include the triple bottom line philosophy and practices, social entrepreneurship, and microfinancing. These movements and practices are based on related premises and have in common a theme that serving society and the environment is also profitable. These are not new trends, but they are becoming more popular and acceptable ways of doing business given the social, environmental, and moral problems businesses have and are experiencing at the expense of societies worldwide.

The **triple bottom line** is "... a kind of balanced scorecard that captures in numbers and words the degree to which any company is or is not creating value for its shareholders and for society."<sup>90</sup> This philosophy is based on "the sustainability imperative," i.e. the realization that in order for the environment to be preserved and society to benefit from business, corporations must respect the "interdependence of various elements in society on one another on the social fabric. Sustainability means operating a business in a way that acknowledges the needs and interests of other parties ... and that does not fray but rather reinforces the network of relationships that ties them together."<sup>91</sup> The triple elements of this scorecard argue that business activity should be measured in economic, environmental and social costs and benefits. The **economic dimension**

includes: sales, profits, ROI (return on investment), taxes paid, monetary flows, and jobs created. The **environmental dimension** includes air and water quality, energy usage, and waste produced. The **social dimension** includes labor practices, community impacts, human rights, and product responsibility. “The sustainability sweet spot” where “increase profits and marketshare” and “address climate change and public health” intersect indicates where a corporation’s profits can be made. This has been demonstrated in several companies such as Tropicana and Quaker Oats healthy products, Pepsico’s environmental policy and procedures changes, Toyota’s hybrid cars, General Electric’s clean technology (“ecomagination”) products.

## Social Entrepreneurs and Social Enterprises

A social enterprise is “an organization or venture that advances its social mission through entrepreneurial, earned income strategies.”<sup>92</sup> Social entrepreneurs “. . . are individuals with innovative solutions to society’s most pressing social problems. They are ambitious and persistent, tackling major social issues and offering new ideas for wide-scale change. Rather than leaving societal needs to the government or business sectors, social entrepreneurs find what is not working and solve the problem by changing the system, spreading the solution, and persuading entire societies to take new leaps.”<sup>93</sup> Social entrepreneurship and enterprises date back to the 1960s and 1970s<sup>94</sup> and include non-profits, community groups, youth social entrepreneurial groups, as well as the private and governmental sectors. Some NGOs (non-governmental organizations) are also related to social enterprises. *Fast Company* magazine listed the 2008 *Social Capitalist Awards* that announced 45 social entrepreneurs “who are changing the world.”<sup>95</sup>

Another related movement that is making a difference for the poor globally is **microfinancing**.<sup>96</sup> Microfinancing involves “. . . very small loans, typically less than \$100. . . made to the rural poor in developing countries who normally do not qualify for traditional banking credit. This is often the only way they can establish a business and lift themselves out of poverty.”<sup>97</sup> Microfinancing is the idea of Professor Yunus, who in 1976 founded the Grameen Bank after a famine in Bangladesh. The loans grew to 6.6 million borrowers, of whom 97% are women. The Nobel peace prize was awarded to Yunus and his Grammen bank in 2006 for this practice. “Grameen, which means village, is an idea that has spread to more than 40 countries including Sri Lanka where women’s banks were already a familiar concept”<sup>98</sup>

## 8.6 MNEs: STAKEHOLDER VALUES, GUIDELINES, AND CODES FOR MANAGING ETHICALLY

Guidelines for managing international ethical conduct have received detailed attention and effort over the past four decades in the areas of consumer protection, employment, environmental pollution, human rights, and political conduct.<sup>99</sup> Figure 8.6 illustrates issues and ethical concerns that MNEs must manage. The driving institutional forces behind the development of

global ethical values, published guidelines, and universal rights include the United Nations, the International Labor Office, the Organization for Economic Cooperation and Development (OECD), the CERES Principles on the Environment, the Conference Board, and the Caux Round Table Principles for Business.

The underlying normative sources of the guidelines that these global organizations developed include beliefs in (1) national sovereignty, (2) social equity, (3) market integrity, and (4) human rights and fundamental freedoms.<sup>100</sup> DeGeorge specifically offers the following guidelines that multinationals can use in dealing with LDCs:

1. Do no intentional harm.
2. Produce more good than harm for the host country.
3. Contribute to the host country's development.
4. Respect the human rights of their employees.
5. Respect the local culture; work with, not against, it.
6. Pay their fair share of taxes.
7. Cooperate with the local government to develop and enforce just background institutions.
8. Majority control of a firm includes the ethical responsibility of attending to the actions and failures of the firm.
9. Multinationals that build hazardous plants are obliged to ensure that the plants are safe and operated safely.
10. Multinationals are responsible for redesigning the transfer of hazardous technologies so that such technologies can be safely administered in host countries.<sup>101</sup>

Other developments involving global companies and business ethics include the following: (1) global companies are, as discussed earlier, developing and using core principles relevant to their business practices; (2) codes of ethics with minimum social responsibility standards (e.g., gender discrimination and environmental responsibility) are being adopted and employees are being trained on them; and (3) a broad consensus for ethical requirements is being articulated. The Conference Board, a global network of businesses, academic institutions, governments, and non-governmental organizations (NGOs) in more than 60 countries, is working to define global business practice standards, core principles for doing business across cultures, and the requirements for the support of and cooperation between business and nonbusiness institutions.<sup>102</sup>

Some classic guidelines that continue to influence policies and practices of global companies are presented next. The following MNE guidelines are summarized under the categories of employment practices and policies, consumer protection, environmental protection, political payments and involvement, and basic human rights and fundamental freedoms.<sup>103</sup>

## Employment Practices and Policies

- MNEs should not contravene the workforce policies of host nations.
- MNEs should respect the right of employees to join trade unions and to bargain collectively.

- MNEs should develop nondiscriminatory employment policies and promote equal job opportunities.
- MNEs should provide equal pay for equal work.
- MNEs should give advance notice of changes in operations, especially plant closings, and mitigate the adverse effects of these changes.
- MNEs should provide favorable work conditions, limited working hours, holidays with pay, and protection against unemployment.
- MNEs should promote job stability and job security, avoiding arbitrary dismissals and providing severance pay for those unemployed.
- MNEs should respect local host-country job standards and upgrade the local labor force through training.
- MNEs should adopt adequate health and safety standards for employees and grant them the right to know about job-related health hazards.
- MNEs should, minimally, pay basic living wages to employees.
- MNEs' operations should benefit the low-income groups of the host nation.
- MNEs should balance job opportunities, work conditions, job training, and living conditions among migrant workers and host-country nationals.

### **Consumer Protection**

- MNEs should respect host-country laws and policies regarding the protection of consumers.
- MNEs should safeguard the health and safety of consumers by various disclosures, safe packaging, proper labeling, and accurate advertising.

### **Environmental Protection**

- MNEs should respect host-country laws, goals, and priorities concerning protection of the environment.
- MNEs should preserve ecological balance, protect the environment, adopt preventive measures to avoid environmental harm, and rehabilitate environments damaged by operations.
- MNEs should disclose likely environmental harms and minimize the risks of accidents that could cause environmental damage.
- MNEs should promote the development of international environmental standards.
- MNEs should control specific operations that contribute to the pollution of air, water, and soils.
- MNEs should develop and use technology that can monitor, protect, and enhance the environment.

### **Political Payments and Involvement**

- MNEs should not pay bribes or make improper payments to public officials.
- MNEs should avoid improper or illegal involvement or interference in the internal politics of host countries.

## Basic Human Rights and Fundamental Freedoms

- MNEs should respect the rights of all persons to life, liberty, security of person, and privacy.
- MNEs should respect the rights of all persons to equal protection of the law, to work, to choice of job, to just and favorable work conditions, and to protection against unemployment and discrimination.
- MNEs should respect each person's freedom of thought, conscience, religion, opinion and expression, communication, peaceful assembly and association, and movement and residence within each state.
- MNEs should promote a standard of living to support the health and well-being of workers and their families.
- MNEs should promote special care and assistance to motherhood and childhood.

Frederick<sup>104</sup> states that these guidelines should be viewed as a “collective phenomenon,” because all do not appear in each of the five international pacts they originated from: the 1948 United Nations Universal Declaration of Human Rights, 1975 Helsinki Final Act, 1976 OECD Guidelines for Multinational Enterprises, 1977 International Labor Organization Tripartite Declaration of Principles Concerning Multinational Enterprises and Social Policy, and 1972 United Nations Code of Conduct on Transnational Corporations.

The guidelines serve as broad bases that all international corporations use to design specific policies and procedures; these corporations can then apply their own policies and procedures to such areas as “[c]hild care, minimum wages, hours of work, employee training and education, adequate housing and health care, pollution control efforts, advertising and marketing activities, severance pay, privacy of employees and consumers, and information concerning on-the-job hazards.”<sup>105</sup>

## 8.7 CROSS-CULTURAL ETHICAL DECISION-MAKING AND NEGOTIATION METHODS

“You are a manager of Ben & Jerry’s in Russia. One day you discover that the most senior officer of your company’s Russian venture has been ‘borrowing’ equipment from the company and using it in his other business ventures. When you confront him, the Russian partner defends his actions. After all, as a part owner of both companies, isn’t he entitled to share in the equipment?”<sup>106</sup> These and so many other international business situations confront managers and professionals with dilemmas and gray areas in their decision making. As one author noted, “Global business ethics has now become the ultimate dilemma for many U.S. businesses.”<sup>107</sup>

“Transnationals operate in what may be called the margins of morality because the historical, cultural, and governmental mores of the world’s nation-states are not uniform. There is a gray area of ethical judgment where standards of the transnational’s home country differ substantially from those of the host country. . . . [T]here is yet no fixed, institutionalized

policing agency to regularly constrain morally questionable practices of transnational commerce. Moreover, there is no true global consensus on what is morally questionable.”<sup>108</sup> Scholars and business leaders agree that solving ethical dilemmas that involve global, cross-cultural dimensions is not easy. Often there are no “quick fixes.” Where other laws, business practices, and local norms conflict, the decision makers must decide, using their own business and value judgments. Ethics codes help, but decision makers must also take local and their own company’s interests into consideration. In short, there is no one best method to solve international business ethical dilemmas. From a larger perspective, external human rights and corporate monitoring groups are also needed to inform and advise corporations before dilemmas occur about human rights and methods that can prevent abuses of local workers and private citizens.

### External Corporate Monitoring Groups

Corporations and their leaders are ultimately responsible for articulating, modeling, and working with international stakeholders to enforce legal and ethical standards in their firms as they do business around the world. Many do. However, as noted earlier, gray areas and lack of universal laws and norms leave loopholes that companies and local groups might use as competitive, but harmful, cost-saving advantages (e.g., not providing even “living wages” to the poor women and children they employ, polluting the environment, and using undue political influence to beat out competition). Numerous international groups<sup>109</sup> that work with and monitor MNEs regarding human rights include—but are not limited to—Amnesty International (promotes and advocates human rights), OECD (developed Guidelines for Multinational Enterprises), International Labor Organization (publishes and works in the area of human rights), NGOs (combat corruption, assure adequate labor conditions, and establish standards for economic responsibility), Transparency International (monitors and publishes the international Corruption Perception Index), Apparel Industry Partnership (which develops codes of conduct regarding child labor practices and working conditions related to “sweat shops” and subcontractors), and The Round Table (an executive group formed in Switzerland that published the noted Caux Principles and works with other international business professionals on developing and implementing universal ethics codes). These groups work with, and some are composed of, MNE executives, governments, legislators, local citizenry, and other stakeholders worldwide to inform, monitor, and assist MNEs with ethical global business practices.

Demands for greater corporate transparency and accountability, as well as anti-corruption measures are fostering significant new accountability, reporting, and transparency initiatives among coalitions of business, labor, human rights, investor, and governmental bodies. . . . A database created by the International Labor Organization and available over the Internet lists nearly 450 Web sites of industry and business associations, corporate, NGO and activist groups, and consulting organizations that have developed and are promulgating a wide range of relevant policy initiatives. These initiatives include a mix of transparency and reporting initiatives, codes of conduct, principles, and fair trade agreements.

Responses to these demands are varied. Many companies, particularly those under NGO and social activist pressures to reform labor and human rights abuses in their supply chains, have formulated their own codes of conduct. Notable among these companies are Levi-Strauss, Nike, and Reebok, all significant targets of activism.<sup>110</sup>

In the following section, several guidelines are discussed to complement principles and “quick tests” presented in Chapter 3.

## Individual Stakeholder Methods for Ethical Decision Making

In an international environment, the temptations can be strong, and the laws looser, or less obvious. Pressure from headquarters to make the bottom line can also weigh heavily. “Sometimes people confuse norms with ethics—exploitation of child labour, bribery and kickbacks may be the norm, but that doesn’t mean they’re right—and that’s what companies need to deal with,” says Joseph Reitz, who is co-director of the International Center for Ethics in Business at the University of Kansas. “There’s lots of evidence that companies insisting on doing business in the right way may suffer in the short term, but in the long run they do well.”<sup>111</sup> Or do they?

Individual employee and professional stakeholders—when confronted with cross-cultural ethical dilemmas, conflicting norms, and potentially illegal acts in international situations, like the case of Louise in Chapter 3, need guidelines. Professionals and executives preparing to work abroad should ask for country-specific training on regional and local laws, customs, and business practices. As noted earlier, these professionals need to know their own firm’s acceptable and unacceptable policies and procedures regarding negotiations and business dealings. This section introduces some—but obviously not all—guidelines that are a beginning step to becoming aware of the cultural differences and potential ethical consequences of doing business in other regions and countries.

DeGeorge<sup>112</sup> offers the following general tactics that serve as a basic start for preventing, as well as solving, ethical dilemmas internationally:

1. Do not violate the very norms and values that you want to preserve and that you use to evaluate your adversary’s actions as being unethical. Seek to pursue with integrity economic survival and self-defense tactics. Winning a tactical battle unethically or illegally is not the goal.
2. Use your moral imagination, because there are no specific rules for responding to an ethical opponent. Stakeholder analysis can help. Explore different options. Use literature, stories, and lives of heroes and saints for creative responses instead of rules.
3. Use restraint and rely on those to whom the use of force is legitimately allocated when your response to immorality involves justifiable force or retaliation. Use minimal force that is justified as the ultimate solution, realizing that force is a reaction to unethical acts and practices.
4. Apply the principle of proportionality when measuring your response to an unethical opponent. The force you use should be commensurate with the offense, the harm suffered, and the good to be gained.

5. Use the technique of *ethical displacement* when responding to unethical forces. This principle consists of searching for clarification and a solution to a dilemma on different, higher levels than the personal (e.g., as discussed in Chapter 1, look at the problems from these levels: international, industry, organizational, structural, and national or legislative policy).
6. Use publicity to respond to an unethical practice, adversary, or system. Corruption, unethical and illegal practices and actions, operates best in the dark. Using publicity judiciously can mobilize pressures against the perpetrators.
7. Work jointly with others to create new social, legal, or popular structures and institutions to respond to immoral opponents.
8. Act with moral courage and from your values, personally and corporately.
9. Be prepared to pay a price, even a high one. Innocent people sometimes must pay costs that others impose on them by their unethical and illegal activities.
10. Use the principle of accountability when responding to an unethical activity. Those who harm others must be held accountable for their acts.

**Getting to Yes** Solving a moral dilemma in an international context is not easy. Fisher, Patton, and Ury's book *Getting to Yes: Negotiating Agreement Without Giving In* (alluded to earlier in this text) remains a classic primer for negotiating. Their four-step approach includes:

1. Separate the people from the problem.
2. Focus on interests, not on positions.
3. Insist on objective criteria, never yield to pressure.
4. Invent options for mutual gain.

The authors note that it is always necessary to determine your best alternative to a negotiated solution before starting a negotiation.<sup>113</sup>

Building on Fisher, Patton, and Ury's method, Nancy Adler states that formal negotiations, especially in an international or cross-cultural context, proceed through four stages after preparing for a negotiation:

1. Build interpersonal relationships (learn about the people)—separate people from the problem.
2. Exchange task-related information—focus on interests, not positions.
3. Persuade—invent options for mutual gain, instead of relying on preconceived positions, high pressure, or “dirty tricks.”
4. Make concessions and agreements—use objective decision criteria.<sup>114</sup>

**Understand the Local Culture First** Is local culture important or are people across cultures becoming more alike, especially with globalization and for those working in MNEs? Studies show that although organizations are becoming more alike in their structures and technologies, individuals maintain and even emphasize their cultural behaviors even more. National culture explains more about employees' attitudes and behaviors than does age, gender, role, or race.<sup>115</sup> When communicating and negotiating



in different cultural contexts, gaining an understanding of the local culture in preparing for the negotiation is recommended before using any specific negotiation technique. Cultural miscues and disconnects are grounds for creating and exacerbating ethical problems and dilemmas. Consider, then, these cultural differences before problem solving or negotiating with counterparts:

- What are the dominant, underlying values of the culture? (Are groups, families, and collectives and their decisions valued over individuals and individual decisions, or vice versa?)
- How formally or informally are relationships viewed? (Is it necessary to get to know someone before negotiating, or is jumping to the facts first acceptable?)
- How do people understand and value rules versus spontaneity and bending rules? (Do friendships come before rules or are rules seen as unbreakable and applicable to all?)
- How are authority and power viewed? (Is position and status valued more than experience? Is the boss more often seen as being right regardless of “the facts”?)
- Is age respected as indicating wisdom and authority?
- To what extent does the culture avoid or embrace uncertainty and risk? (Are people threatened by ambiguity and therefore avoiding unpredictability?)

Sources that address these and other comparative cultural differences are readily available.<sup>116</sup>

Figure 8.7 illustrates different styles of negotiation among North Americans, Japanese, and Latin Americans, based on cultural values and characteristics. Can you see how ethical problems and dilemmas could arise from communication miscues among professionals from these countries negotiating a complex transaction? Consider the same questions while viewing Figure 8.7 which shows strategies for negotiating with Americans, Japanese, Chinese, and Brazilians.

It is helpful to understand how other cultures perceive, understand, and perhaps even stereotype American cultural characteristics. (Obviously, not everyone from every culture reflects all of his/her national culture's characteristics.) For example, characteristics most commonly associated with Americans from the different nationals reveal interesting patterns (e.g., although Americans were largely seen as industrious, inventive, intelligent, decisive, and friendly by an interview sample of French, Japanese, Western Germans, British, Brazilians, and Mexicans, Americans were also seen as nationalistic, rude, and self-indulgent by Japanese; sophisticated by western Germans; nationalistic by Brazilians; and greedy by Mexicans).<sup>117</sup> Becoming self-aware of one's cultural characteristics (attitudes, values, behaviors, and other's perceptions of us) is an important step toward business transactions in order to prevent and negotiate ethical dilemmas.

Figure 8.7

### Negotiating Strategies with American, Japanese, Chinese, and Brazilian Cultures

American Negotiators	Japanese Negotiators	Chinese (Taiwan) Negotiators	Brazilian Negotiators
Preparation and planning skill	Dedication to job	Persistence and determination	Preparation and planning skill
Thinking under pressure	Perceive and exploit power	Win respect and confidence	Thinking under pressure
Judgment and intelligence	Win respect and confidence	Preparation and planning skill	Judgment and intelligence
Verbal expressiveness	Integrity	Product knowledge	Verbal expressiveness
Product knowledge	Demonstrate listening skill	Interesting	Product knowledge
Perceive and exploit power	Broad perspective	Judgment and intelligence	Perceive and exploit power
Integrity	Verbal expressiveness		Competitiveness

**SOURCE:** "Culture Based Negotiation Styles." July 2003. Beyond Intractability. 23 April 2008 [http://www.beyondintractability.org/essay/culture\\_negotiation/](http://www.beyondintractability.org/essay/culture_negotiation/). Chinese and Brazilian Cultures Source: LeBaron, Michelle.

### Four Typical Styles of International Ethical Decision Making

At a more macro level, George Enderle<sup>118</sup> identified four distinctive international ethical decision-making styles that companies often use when making decisions abroad: (1) Foreign Country style: a company applies the values and norms of its local host—"When in Rome, do as the Romans do"; (2) Empire style: a company applies its own domestic values and rules; this can be an imperialistic practice; (3) Innerconnection style: a company applies shared norms with other companies and groups; national identities and interests are transcended and blurred, as when states make commercial decisions and rely on NAFTA or the EU members to offer agreed-on processes and solutions; and (4) Global style: a company abstracts all local and regional differences and norms, coming up with a more cosmopolitan set of standards and solutions for its actions in the host country.

The Foreign Country and Empire styles have obvious drawbacks in reaching ethical decisions. The Foreign Country style may result in gross injustices and inequities that are inherent in the norms adopted. Some local country norms and business practices, for example, do not prohibit

child labor. The second style is a form of imperialism that disregards local norms and practices. The Global style, seemingly the “right answer,” also presents problems. This style imposes its own interpretation of a “global morality and truth” on a host culture and norms. The Global style can also suffer from shortcomings shared by the Foreign Country and Empire styles. The Interconnection style “acknowledges both universal moral limits and the ability of communities to set moral standards of their own. It balances better than the other types a need to retain local identity with the acknowledgment of values that transcend individual communities. The drawbacks of this style are practical rather than moral.” Companies and individual employees usually do not have quick or direct access to a commonly shared local, national, and international source to advise on a particular issue. Of the four styles, the Interconnection style appears to be less arbitrary and absolutist.<sup>119</sup> Another option is creative ethical navigation (which Donaldson and Dunfee term “integrative social contract theory” or ICST). This is not really a “style” of decision making; rather, it is the process of a decision maker navigating among “hypernorms,” company interests, and local norms, as explained in the following section.

### **Hypernorms, Local Norms, and Creative Ethical Navigation**

It would be helpful to have a set of norms that everyone agreed on. Hypernorms represent such an ideal. “Hypernorms are principles so fundamental that, by definition, they serve to evaluate lower-order norms, reaching to the root of what is ethical for humanity. They represent norms by which all others are to be judged.”<sup>120</sup> Hypernorms relate to universal rights: for example, the right not to be enslaved, the right to have physical security, the right not to be tortured, and the right not to be discriminated against.<sup>121</sup> However, the problem even with hypernorms is that when “rights,” local traditions, country economic systems, or business practices conflict, decisions have to be made; in such cases, it is necessary for a manager or professional to use his or her hypernorms as a starting principle, but then to be creative in considering the local context and competing norms. Reaching a win-win situation without violating anyone’s norms is an ideal goal. An example of such a troublesome gray area, along with a suitable solution, is offered by Donaldson and Dunfee:

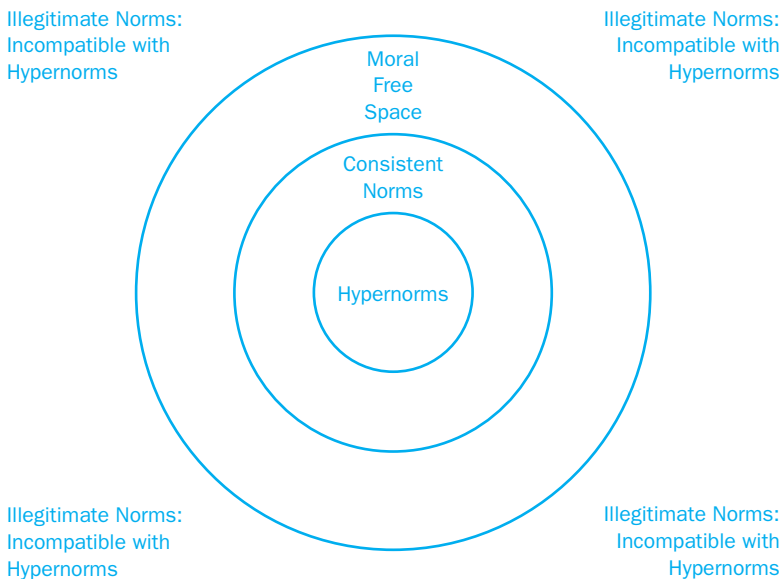
Consider another situation confronted by Levi-Strauss, this time involving hypernorms connected with child labor. The company discovered in the early 1990s that two of its suppliers in Bangladesh were employing children under the age of fourteen—a practice that violated the company’s principles but was tolerated in Bangladesh. Forcing the suppliers to fire the children would not have insured that the children received an education, and it would have caused serious hardship for the families depending on the children’s wages. In a creative arrangement, the suppliers agreed to pay the children’s regular wages while they attended school and to offer each child a job at age fifteen. Levi-Strauss, in turn, agreed to pay the children’s tuition and provide books and uniforms. This approach allowed Levi-Strauss to uphold its principles and provide long-term benefits to the host country.<sup>122</sup>

Figure 8.8 illustrates Donaldson and Dunfee's "Global Values Map," which portrays the zones groups may consider to creatively navigate among and reach agreement on competing norms and business practices.<sup>123</sup> At the center of the figure are "hypernorms," which are basic values acceptable to all cultures and organizations. The next concentric circle represents "consistent norms," which are culture-specific values but still consistent with both hypernorms and other legitimate norms. Ethical codes of companies, such as Johnson & Johnson's Credo, are examples of consistent norms. Moving away from the center of the circle to the outer circle, one encounters inconsistent norms, which may conflict with hypernorms and/or local business practices. Outside the concentric circle are illegitimate norms—values or practices that transgress hypernorms (e.g., exposing workers to asbestos or other carcinogens). In the "moral free space," a company can creatively explore unique solutions that satisfy all parties.

The previous example of Levi-Strauss illustrates a process using Figure 8.8. Levi-Strauss had to decide among a "hypernorm" (child labor is wrong), its own company norms ("consistent norms"—children cannot be hired or used by company suppliers), and Bangladesh suppliers' child labor practices ("illegitimate norms") to reach an agreement that would benefit the children and their families. Levi-Strauss entered the "moral free space" and worked out what seems to have been a "win-win" situation for all parties involved—and an arrangement that brought no harm to any party.

Figure 8.8

### Global Values Map



**SOURCE:** Reprinted by permission of *Harvard Business Review* from "Ties that bind: A social contract approach to business ethics" by T. Donaldson and T. Dunfee. Copyright © 1999 by the Harvard Business School Publishing Corporation. All rights reserved.

Finding such creative solutions to international moral dilemmas involves balancing and combining business pressures, legal enforcement, and political will. A company attempting to make tough decisions with local groups could also seek to do so with the cooperation of other companies, local government officials, or even an external human rights group as the Inter-connectedness style of decision making would suggest. The ultimate decision may very well entail no compromise after reflecting on the situation, the hypernorm, and a company norm. Still, the methods discussed here can enable a decision maker—individual or global or company team—to look for options without getting trapped into blind absolutes, amoral gray zones, or relativism. Entering “moral free space” requires flexibility and negotiating. The embedded process in Figure 8.8 also enables a company or individual decision maker to use the principles and quick tests discussed in Chapter 3.

## CHAPTER SUMMARY

The global environment consists of multinationals managing a dynamic set of relationships among country governments, international organizations, and each other. Elements of those relationships consist of financial markets, cultures, political ideologies, government policies, technologies, and laws. There are estimates of between 40,000 to 100,000 multinational companies doing business across national boundaries and contributing to the global economy. It is likely these numbers will increase. Also, emerging markets in such countries as what is referred to as “BRIC” (Brazil, Russia, India, and China) have and are helping to reshape the global landscape. New and competitive opportunities created by information technologies and the “flattening” of boundaries through the emergence of global supply chains, outsourcing and China’s “cost innovation” business model abound through mass production.

Globalization is the integration of technology, markets, politics, cultures, labor, production, and commerce. Globalization is both the process and the result of this integration. The global economy is estimated at \$33 trillion. As the complexity and volatility of the global environment increases, the probability of ethical dilemmas and conflicts is also enhanced. The post 9/11 world has also created different constraints and costs on business and nations: the economic, legal, moral, and social pressures businesses face have several industries continuing to struggle for survival and profitability.

Forces that have accelerated globalization include the end of communism and the opening of closed economies; information technologies and the Internet, which accelerate communication and productivity within and across companies globally; entrepreneurship and entrepreneurs who are more mobile, skilled, intelligent, and thriving worldwide; free trade and trading agreements among nations; the flow of money through the World Bank and the International Monetary Fund (IMF), which offers a conduit to bring needed capital to countries participating in building

the global economy; the growth and the spread of transnational firms, which open new markets and create local employment; and a shift to service economies and educating workers using technologies, which has also propelled innovation and productivity worldwide. A continuing question asked is: Will globalization and accelerated business integration across national borders be slowed or rejuvenated through new and changing business, governmental, and entrepreneurial alliances, including ongoing corruption and “bubbles” bursting in different national economies felt around the world?

Major corporations play significant economic and ethical roles in helping rejuvenate the global and local economies. “Smart globalization” strategies and processes are used by several companies and include the following: (1) methodically building a presence from the ground up instead of planning takeovers and acquisitions; (2) doing extensive homework before starting a business in a developing country by consulting with and learning from local stakeholders; (3) forgetting about targeting the richest 10% of the global population and marketing to the 4 billion people internationally who earn less than \$1,500 annually and are the source of future growth; and (4) introducing and helping to stimulate product use with local populations.

The “dark side of globalization” includes such issues as corporate crime and corruption, child slave labor, Westernization (Americanization) of values, the global digital divide, and loss of nation-state sovereignty. Also, critics argue that the “McDonaldization of Society” delivers cultural values as well fast food. This is a debatable issue and is discussed in the chapter.

The power of MNEs or global companies lies in their size, economic prowess, and ability to locate and operate across national borders. MNEs offer benefits to their host countries by employing local populations, investing capital, co-venturing with local entrepreneurs and companies, providing enhanced technology, developing particular industry sectors, providing business learning and skills, and increasing industrial output and productivity.

MNEs also abuse their power by committing corporate crimes, exerting undue political influence and control, determining and controlling plant closings and layoffs, and damaging the physical environment and human health. Guidelines drawn from more than four decades of international agreements and charters were summarized to illustrate a consensus of host-country rights that have been used to help MNEs to design equity into their policies and procedures.

Finally, principles from *Getting to Yes: Negotiating Agreement Without Giving In* were extended to include understanding cross-cultural characteristics of decision makers to prevent ethical dilemmas and negotiate complex business transactions. A creative model was summarized enabling companies to reach agreements among conflicting hypernorms (universal rights), consistent norms (company ethics and values codes), and illegitimate norms. Being able to balance local cultural norms, a company’s norms, and competing business practices involves creative and responsible navigation and decision-making skills based on personal, professional, company, and universal values.

## QUESTIONS

1. Briefly characterize the emerging competitive global business environment and identify some of the forces that define it.
2. What is “globalization?” What are some of the forces driving this process?
3. What competencies do you (a) have, and (b) need if you were to join—or are already working for—a global company in which you would spend time in different countries?
4. What differences, if any, in your ethical principles and morals do you believe you would have to adjust to in negotiating with other cultures (see Figures 8.7 and 8.8)?
5. What adjustments to your values and ethical decision making style have you had to make in teams in your own culture, and with others from different cultures in your studies and/or work? Explain.
6. What is the difference between a gift and a bribe? How would you, as a representative of your company, respond to the offer of a questionable bribe from an international government or business professional? Explain.
7. Does globalization result in cultural and economic homogenization (alikehood) through a heightened emphasis on consumerism, or is this an exaggeration? Explain and defend your position.
8. Do local and global values change as a result of international integration? Why or why not? If so, in what ways? Offer a few examples.
9. Do you believe that globalization “promotes the conversion of national economies into environmentally and socially harmful export-oriented systems for business competition” that is not in the best interests of consumers? Why or why not? Defend your position.
10. Select two global companies mentioned in this chapter and locate their corporate Web sites. Find their codes of conduct or ethics statements. Download these and evaluate whether or not they serve any practical purposes or help meet the companies’ social responsibility goals and why.
11. Explain what the “dark side of globalization” means to you. Offer some examples. Offer an additional issue that could be considered a dark side of globalization. After doing so, offer a realistic solution that could either eliminate, change, or transform the dark side of your issue.
12. Do you believe Facebook, MySpace, and other such social networking Web sites are, will, or can promote more commonly shared values of people across cultures—knowing that some countries have their own such Web sites in their language? Explain.
13. Are you or have you thought about becoming a “social entrepreneur”? Do you believe this practice and movement can help make a difference in the world? Explain.

14. Explain the differences in perception and experience with regard to moral issues for (a) a host country viewing an MNE and (b) an MNE viewing a host country. Which perspective are you more inclined to support or sympathize with? Why?
15. In a paragraph or list, describe dominant cultural characteristics of yourself as could be seen from another country or regional perspective. Include some of your core values. Then proceed to the next question.
16. Using your description from question 15, what difficulties or misunderstandings based only on your answer would you predict that you might encounter when negotiating an ethical dilemma with someone who had opposite cultural characteristics? Explain.
17. Find an example from the media, cinema, or someone's experiences of an international dilemma a person or company has had in a host country, and apply the process of the "Global Values Map." Evaluate how well you believe the process could have worked in the example you found.

## EXERCISES

1. Argue and defend your positions on the following statements:
  - (a) The U.S. is already and will continue to lose its status as a central, pivotal global superpower, including its cultural and values influence, in the world in the next 10 to 20 years if not sooner.
  - (b) Censorship restrictions in other countries on such information technology as Google and other Web sites is justifiable; U.S. and other western nations should not try to impose their values and norms on censoring practices.
  - (c) A "global set of ethics" is impossible. Each culture and region of the world should have its own ethics as well as values and cultural differences.
  - (d) To succeed, globalization must involve justice and fairness practices from "First World" countries toward "Third World" nations and peoples.
  - (e) Although it is preferable that transnational and multinational companies act ethically, it is really not practical in every region of the world, including the U.S.
  - (f) MNEs cannot financially afford to follow the guidelines in Section 8.5; it would be too costly for them.
  - (g) When two MNEs are both right on a controversial issue—for example, violation of patent or intellectual property rights—ethics should be avoided, and other, more concrete issues should be used to resolve the dispute.
  - (h) Without transnational companies and MNEs doing business in poorer countries, peoples of those countries who are striving to survive would suffer even more.



2. Offer an example of and explain why one of your own values or an ethical standard you deeply believe in and follow might conflict with a different cultural or regional ethic in, for example, China, Russia, the Middle East, or the U.S. (if you are from a different culture). How flexible would you be, or not be, in negotiating one of your core beliefs in another culture? What would be your constraints on being flexible and changing your value-based position? Explain.
3. Evaluate and argue different sides of this statement: "McDonaldization is not a 'bad' thing. Everyone has a choice of what and how much to buy and consume. People are lucky to have a low cost food option like McDonald's."

**REAL-TIME ETHICAL DILEMMA**

You (Jane) are a 29-year-old single woman who has an MBA and has been working in your current marketing position for a year. Your firm recently opened a new pilot branch in a somewhat remote Russian location. The CEO of your company believes there are real growth opportunities for your firm's products in that region and also wants visibility there. The company has decided to launch a small office there for visibility as well as to introduce the product. You are one of the most outgoing and talented marketing professionals in your firm. It is believed that you'll make a positive impression and represent the company well. There is a small community of American business professionals there who will assist you.

Country values there are very different from what you are accustomed to. You overhear a discussion between two of your male colleagues who were recently in that country completing arrangements for the office. One says, "Jane's going to have some interesting challenges with the men she has to do business with. . . . It's like the Wild West." The other answered, "Yeah, she's got some real surprises coming." Your research

suggests that country laws and norms on issues you take for granted (like women's rights and sexual harassment) are not well defined.

You have a conflict over wanting to advance with your company but not wanting to take this assignment. You are aware that the CEO has his mind set. In fact, you've already had a discussion expressing your concerns and fears. He brushed your issues aside when he told you earlier, "Jane, try it. You need the international exposure and experience." The second time you approached him with your concerns, he blurted out, "Look, Jane. I understand your concerns, but this is important to me and our company. There are some people there who can help you. I know it's going to be a challenge. But after a couple of years, you'll thank me." You still don't feel right.

**Questions**

1. What do you do, and why?
2. If you do decide to go, what specific preparations should you make?
3. If you decide not to go, draft out the dialogue you would have with your CEO.

## REAL-TIME ETHICAL DILEMMA



You are attending a sexual harassment training seminar for local managers in your company's branch office in a Middle Eastern, predominately Muslim, country. You were flown over with the trainers to observe their techniques and become familiar with the training materials because you, as a new human resource staff member, would be expected to give this course. The course has been a success for managers in the United States. The same materials have been perfected and are being used in the United States. The instructors call on local Muslim managers (men and women) to role play and openly share stories about sexual harassment that involved them or that they had heard about. Near the end of the half-day session, several of the host country employees uncharacteristically walk out. The trainers are dazed and become upset.

### Questions

1. What do you think went wrong?
2. What would you do in this case if you were one of the trainers?
3. Read the epilogue following, then return and answer this question: "Assume the trainers have been briefed on the research you just read. Who should do

what, if anything, with the Muslim managers after this cultural mishap? Why?"

### Epilogue

"In 1993, a large U.S. computer-products company insisted on using exactly the same sexual harassment exercises and lessons with Muslim managers halfway around the globe that they used with American employees in California. It did so in the name of 'ethical consistency.' The result was ludicrous. The managers were baffled by the instructors' presentation, and the instructors were oblivious of the intricate connections between Muslim religion and sexual manners.

"The U.S. trainers needed to know that Muslim ethics are especially strict about male/female social interaction. By explaining sexual harassment in the same way to Muslims as to Westerners, the trainers offended the Muslim managers. To the Muslim managers, their remarks seemed odd and disrespectful. In turn, the underlying ethical message about avoiding coercion and sexual discrimination was lost. Clearly sexual discrimination does occur in Muslim countries. But helping to eliminate it there means respecting—and understanding Muslim differences."

**SOURCE:** Donaldson, T., Dunfee, T. (Summer 1999). When ethics travel: The promise and peril of global business ethics. *California Management Review*. 41(4), 60.

## Case 22

### China, India, and Wal-Mart: Issues of Price, Quality, and Sourcing

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Sam Walton understood the immense clout of the company he created—long before it was the largest retailer in the United States or the largest corporation in the world. In 1985, he launched his “Buy American” crusade, offering to work with U.S. manufacturers to bring production back to our shores. In his autobiography, Walton acknowledged that “we had fallen into a pattern of knee-jerk import buying without really examining possible alternatives.” For a time, he took great pride in replacing everything from imported stacking chairs to apparel with U.S. products. However, since Walton’s death in 1992, Wal-Mart’s “Buy American” crusade has clearly evaporated. As Ken Alley writes in the trade magazine, *Plastics News*, “Have you taken a walk through any Wal-Mart throughout North America lately? I will venture a guess that better than 98 percent of all of the shelves throughout Wal-Mart are stocked with items that are not manufactured in the United States, but rather, China, Vietnam, South Korea, Taiwan, India, etc.”

Wal-Mart sources everything from apparel to toys to lighting fixtures to electronics from China, representing about 90% of all the company’s imports. As the largest retailer in the United States, Wal-Mart soaks up a significant chunk of all U.S. imports from China. For instance, in February 2004, China accounted for “80 percent of all bicycles imported into the U.S. and 67 percent of the toys, and 95 percent of all Christmas decorations.” In that same year, Wal-Mart ranked as China’s sixth largest export market just behind Germany.

Critics of Wal-Mart maintain that “the U.S. manufacturing sector is being killed by too-cheap-to-beat Chinese imports.” A Wal-Mart spokesperson,

however, asserts that the retailer still prefers to buy domestically whenever possible but that “some products are simply no longer manufactured in the United States in the volume we need.” Nonetheless, “one domestic supplier after another has been shut out of Wal-Mart’s system largely in favor of Chinese imports, whether inexpensive plastic products or high-tag consumer electronics.” According to Wal-Mart critic Ken Alley, United States’ manufacturers “cannot afford to make products anymore if they want to sell to Wal-Mart and Wal-Mart’s competitors and still make a profit. Wal-Mart’s directives have dictated that value and quality are second-tier issues when compared to price.” Another Wal-Mart critic, Rick Carter, editor-in-chief of the trade magazine *Industrial Maintenance & Plant Operation*, asserts that “the *only* goal of (Wal-Mart’s) buyers is to obtain the lowest possible price, but that buyers have been known to quibble with vendors over one cent of difference.” Carter further states, “If all America needed were low prices, Wal-Mart might be doing its citizens a service.”

Lester Thurow, the noted economist and former dean of the Sloan School of Management at Massachusetts Institute of Technology, makes the point that Wal-Mart is often quick “to junk American suppliers and to replace them with cheaper foreign suppliers.” Wal-Mart is also much more likely “to pressure U.S. suppliers to do whatever it takes to remain in business with the retailer, even if it means sacrificing their own profit margins, closing down plants, and outsourcing jobs to China. If they don’t, they’re likely to be dumped by Wal-Mart in favor of suppliers who can provide the same goods made by people who make a mere fraction of what U.S. workers

earn.” The negative impact of low cost offshore labor is echoed by Shoshana Cohen, a well-respected consultant at PRTM (named for its founding partners Theodore Pittiglio, Robert Rabin, Robert Todd, and Michael McGrath). Asked by Neil Shister, editorial director of *World Trade Magazine*, to identify the key for doing business in a “flat world,” Cohen immediately responded that “contrary to popular belief, the last factor to consider, after everything else, is labor cost.” Moreover, John Byrne, writing in *Fast Company* magazine, argues that “[m]any people are literally shopping themselves, their children, and their friends out of work. These are jobs that the United States would eventually lose to low-wage nations anyway. But Wal-Mart, as a massively powerful force in our economy, is helping accelerate that loss by years and perhaps decades.”

Wal-Mart’s sourcing of products to China because of low cost is taking an increasingly vigorous public thrashing because of product safety and quality concerns. Neil Shister predicts that the summer of 2007 “will be remembered as a pivotal moment when China sourcing was subjected to serious second thoughts. Products manufactured there triggered bans, health alerts, and recalls. Made-in-China fake Viagra, lead-painted toys, toxic toothpaste, and poisonous dog food entered the global supply chain. Indonesia began testing popular imported products from China and found mercury-laced makeup that turns skin black and dried fruit spiked with industrial chemicals. The Philippines warned of candy contaminated with formaldehyde. In Malaysia, it was fungus-infested nuts.”

A Minneapolis-based marketing consulting firm, Strategic Name Development, reported some interesting and revealing results from a survey conducted in August 2007. According to that survey, just 40% of respondents said they could trust Wal-Mart to protect them from products made in China, and 39% of respondents indicated they were more fearful of buying products from Wal-Mart (as compared to 22%

for Wal-Mart’s retail rival, Target). Moreover, 56% of the survey respondents said Wal-Mart was more interested in profits than people; in comparison 41% expressed the same sentiment about Target. In making specific comments, one survey respondent said that Wal-Mart “sold out the American consumer just to make a buck,” and another said, “‘It’s been my policy to avoid all things associated with China, including Wal-Mart . . . I haven’t been [to Wal-Mart] in three months and I used to go weekly.”

The Strategic Name Development survey also indicates that in the aftermath of numerous recalls of Chinese-manufactured products, many consumers would now rather buy goods manufactured in India. Out of 25 different categories of products, consumers indicated a preference for products manufactured in India in all but four categories. Chinese-manufactured products were favored only in the categories of automobiles, cell phones, computers, and flat screen televisions. Moreover, in June 2004, the trade magazine *Furniture/Today* observed that “India’s government is courting Wal-Mart in hopes the retail giant will begin sourcing more products, including furniture, from India instead of China.”

Nonetheless, according to Deloitte Touche Tohmatsu, Wal-Mart is expected to expand its purchases of Chinese goods to as much as \$30 billion annually by the end of the twenty-first century’s first decade. This will be difficult for “U.S. factory workers—if they still have a job, they’re in no position to demand big wage hikes. At the same time, cheap T-shirts and DVD players are crowding U.S. store shelves. It all adds up to low inflation.” Of course, companies like Wal-Mart will probably continue to flourish. As Wal-Mart critic Ken Alley asserts, “The cost of labor and materials are so cheap in China—and most of the Far East for that matter—that you can’t help but make record profits in dealing with Chinese manufacturers.” Allen further argues that “America must put its foot down and make it more difficult for manufacturers of product

lines made outside of the USA to make these record profits. If not, Wal-Mart will continue to grow, more and more manufacturing corporations will close their doors here in the USA, and more bad-quality products will be brought into this country to be handled and potentially ingested by our children.”

### Discussion Questions

1. What are the ethical issues associated with Wal-Mart’s extensive sourcing of low-cost products from China?
2. Based on your experience, does Wal-Mart sacrifice product quality in order to offer customers low prices—always?
3. How does the cost versus quality conundrum affect Wal-Mart’s key stakeholders, including customers, suppliers, and employees?
4. What advice would you give to Wal-Mart’s executives regarding how they could (or should) address the multiple effects of the cost and quality impacts of products sourced from China?
5. What advice would you give to businesses in India that are trying to cultivate supplier relationships with Wal-Mart?
6. What advice would you give to critics of Wal-Mart in order to enhance their impact on the company? To enhance their impact on governmental and regulatory agencies? To enhance their impact on society in general?

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## Case 23

### Google Goes to China

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#### "Do No Evil"?

Google's 2006 decision to conduct business in China was based on an agreement that the company would offer a self-censored version ("Google.cn") of its search engine as required by the government in Beijing. The main issue critics had and have with Google's decision is that the company violated its own values and original philosophy, indicated in the statement, "You Can Make Money Without Doing Evil." For example, Beijing prohibits users from bringing up any results about "the Tiananmen Square protests of 1989, sites supporting the independence movements of Tibet and Taiwan or the Falun Gong movement and other information perceived to be harmful to the People's Republic of China."

The Chinese government's strict Internet censorship policy screens what users can access. A user of Google.cn who tries, for example, to access "the Falun Gong spiritual movement" is denied access and would be directed to a string of condemnatory articles of that movement. A Google spokesperson said that its e-mail, chat room and blogging services would also not be made available since the Chinese government could demand users' personal information. A Google spokesperson did say that the company planned to notify users when access had been restricted on particular search terms.

**Google's Response** Google offered an explanation of their position to operate in China on the Chinese version of Google News China on September 28, 2004. Here are excerpts,

*"There has been controversy about our new Google News China edition, specifically regarding which news sources we include. For users inside the People's Republic of China, we have chosen not to include sources*

*that are inaccessible from within that country. This was a difficult decision for Google, and we would like to share the factors we considered before taking this course of action. For Internet users in China, Google remains the only major search engine that does not censor any Web pages. However, it's clear that search results deemed to be sensitive for political or other reasons are inaccessible within China. For last week's launch of the Chinese-language edition of Google News, we had to decide whether sources that cannot be viewed in China should be included for Google News users inside the PRC. Naturally, we want to present as broad a range of news sources as possible. For every edition of Google News, in every language, we attempt to select news sources without regard to political viewpoint or ideology. For Internet users in China, we had to consider the fact that some sources are entirely blocked. Leaving aside the politics, that presents us with a serious user experience problem. Google News does not show news stories, but rather links to news stories. So links to stories published by blocked news sources would not work for users inside the PRC—if they clicked on a headline from a blocked source, they would get an error page."*

A Google spokesperson stated in another interview that the company can play a more helpful role in China by being there than by boycotting the invitation, even with the concessions. "While removing search results is inconsistent with Google's mission, providing no information (or a heavily degraded user experience that amounts to no information) is more inconsistent with our mission," a statement said.

**Business Incentives** Why do business in China? China is the world's

largest online Internet market, when projected through the year 2008, according to the China Internet Network Information Center (CNNIC). The total number of users in China is estimated at 210 million at the end of 2007. The Nielsen/NetRatings estimated the U.S. Internet population at 216 million during that same period. Statistics from the China Internet Network Information Center show that there are 107 million Internet users in China below age 25; that is almost half of the online population. "These users are ahead of the curve when it comes to social media and new technology take-up. About 33% of young Web users said they had updated their blogs within the previous six months, higher than the average of 23.5% across all users. Similarly, more than 30% said they had used mobile phones to surf the Internet, again higher than the national average." [Online Youth in China, May 21, 2008.]

While Google was a late entrant to the China market (behind Yahoo, AOL, and Microsoft), Google accounted for 26% of that country's Internet-search revenue in the fourth quarter of 2007, up from 17% in 2006, according to Beijing research firm Analysys International. Baidu.com's (China's online search leader) share of the market climbed from 58 % to 60% during the same period.

**Other Internet Companies Enter China** Google followed some of its competitors and related technology firms into China. Yahoo!, AOL, Microsoft, MySpace, and Skype also agreed with China's censorship requirements. Yahoo first purchased a \$1 billion, 40% stake in Alibaba.com, which owned China's largest auction site. Following this transaction, eBay, Amazon, and Interactivecorp—owner of online travel firm Expedia—purchased Chinese firms outright during 2004-2005. Google—before negotiating for direct access in China—acquired a small strategic stake in the online retailer Baidu.com. (It recently sold that 5% stake.) MySpace, owned by Rupert Murdoch's

News Corp., used a strategy that Yahoo and eBay adopted—to operate as locally owned and managed businesses. MySpace is run by IDG, MySpace Inc., and China Broadband Capital Partners LP.

Google's competitiveness is reflected in Figure 1 below, showing that it ranked first followed by Yahoo! for the sites that captured the majority of the search share in the region. Interestingly, "... five of the top ten search properties are local country companies, including China's Baidu.com (16.7 percent) and Korea's NHN Corporation (5.3 percent), which owns search engine Naver.com. Chinese properties Alibaba.com Corporation, Tencent Inc., and Sohu.com Inc., which host Internet-search functionality although they are not strictly search engines, rounded out the list of key local players."

### **Controversies within the Great Wall**

Google and its western counterpart companies have faced controversies in the China relationship. For example:

1. Yahoo was accused in 2005 of supplying data to China that was used as evidence to jail a Chinese journalist for 10 years;
2. Microsoft agreed to censor content from its blog service, Windows Live Spaces, stating that providing Internet services is more helpful to the Chinese than not having a presence in that country;
3. MySpace's Chinese version, which was launched in April of 2007, omitted and filtered certain discussion forum topics such as religion and politics.

Other topics such as the Dalai Lama, Falun Gong, and Taiwan independence were also blocked. Users on the Web site were also able to report "misconduct" of other users for offenses including "endangering national security, leaking state secrets, subverting the government, undermining national unity, spreading rumors or disturbing the social order." Guo Quan's quarrel



● Figure 1

Top 10 Share of Searches of Asia-Pacific Companies April 2008

Top 10 Asia-Pacific Search Properties. Total Asia-Pacific Internet Audience\*, Age 15+ Home & Work Locations Source: comScore qSearch

Top 10 Properties	Searches (MM)	Share of Searches
Total Internet	22,363	100.0
Google Sites	8,737	39.1
Yahoo! Sites	5,366	24.0
Baidu.com Inc.	3,725	16.7
NHN Corporation	1,178	5.3
Alibaba.com Corporation	488	2.2
Microsoft Sites	401	1.8
Lycos Sites	388	1.7
TENCENT Inc.	307	1.4
FRIENDSTER.COM	273	1.2
Sohu.com Inc	178	0.8

\*Excludes searches from public computers such as Internet cafes or access from mobile phones or PDAs.

**SOURCE:** comScore Releases Asia-Pacific Search Share Rankings for April 2008, According to comScore World. <http://www.comscore.com/press/release.asp?press=2289>.

with Google is more recent: “Guo Quan, an expert on classical Chinese literature and the 1937 Nanjing massacre of Chinese civilians by Japanese troops . . . issued [March 2008] an open letter pledging to bring a lawsuit against Google after he discovered that his name had been excised in searches of its Google.cn portal in China.” Quan in the open letter stated, “To make money, Google has become a servile Pekinese dog wagging its tail at the heels of the Chinese communists.” Again, just beneath the impressive business competitiveness and strategic prowess of the western search companies in China lies moral issues that will not be silenced.

**Google in China: Face of the Future? Or Derailed from its Values?** Looking back at a University of California, Berkley, gathering in February 2006, just after Google signed on with China, students chanted “Shame on Google” and “Google, don’t be evil,” before the then Google China President Kai-Fu Lee

spoke. “Students for a Free Tibet,” a group that was critical of Google’s action in China, held signs at the meeting, one stated “Kaifu Leevil.” Alma David, a member of this group and a University of San Francisco law school student, said: “We hope to get the message to Kai-Fu Lee that we won’t stand for censorship. We see a company selling out its values for a profit. Its ‘don’t be evil’ just seems like a bad joke.” Orville Schell, dean of the journalism school of the University of California at Berkeley said, “We are now witnessing the price that companies are willing to pay in order to buy in to China. The business side of the world we’re meeting here simply feels that China cannot be ignored.”

Cheng Siwei, vice chairman of the National People’s Congress of China, said in a 2006 interview in response to Google’s agreement with China . . . “democracy was his country’s final goal. But we must go step by step. We were a backwater country. To speak frankly, there are still anti-Chinese groups spreading rumors about our policies in

order to raise suspicion among our people. We need to have some control.” Victor Chu of First Eastern Investment Group commented that “. . . foreign criticism had failed to recognize that change enters China slowly. The trade-off of Google’s decision to set up even a censored search engine can help that process along. The commentaries are wrong that Google’s entry into China is a sad day for free expression. We should be glad that Google has started a process that is good for free expression. Ideally, of course, China would open up to Google and all foreign media entirely. But that will not happen overnight, and meanwhile, Google has positioned itself very well indeed as a business.”

Frida Ghitis, a writer on world affairs, expressed another view in the *Boston Globe*:

*“Now Google has become a company like all others, one with an eye on the bottom line before anything else. The company has decided to help China’s censors even as it fights a request for records from the U.S. Justice Department’s investigation of online child pornography. Skeptics had claimed Google was resisting the request in order to protect its technology, rather than to protect users’ privacy. That explanation now sounds more plausible than ever.*

*We’ve long known about China’s disdain for individual freedoms. But Google, we hardly knew you. It’s definitely time to rethink that Gmail account and demand some safeguards from a potentially dangerous company. Perhaps here, too, we will need to heed the Tibetan cybercafé warning, “Do not use Internet for any political or unintelligent purposes.”*

## Questions for Discussion

1. What is at issue here from your reading of this case?
2. Do you agree or disagree with Google in this case? Explain.
3. What is your reaction or response to this statement made by a

Google spokesperson in 2006?

*“While removing search results is inconsistent with Google’s mission, providing no information (or a heavily degraded user experience that amounts to no information) is more inconsistent with our mission.”*

4. (a) Defend Google’s argument(s) in accepting to do business in China. (b) Defend the critics who argue that Google betrayed its values when entering China.
5. (a) What ethical principle(s) did Google use (or is Google using) to do business in China with its censorship policy? Explain. (b) What ethical principle(s) are Google’s critics in the case using in not accepting Google’s presence in China?
6. Has anything changed (circumstances, historical events) today from the time Google entered in 2006 that would make a difference in your opinion either justifying or disagreeing with Google’s being in China? Explain.

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## Case 24

### Sweatshops: Are Companies Willing to Solve the Problem?

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Imagine that every day you go to work you are exposed to toxic chemicals without having any protective clothing or safety training, and that the workplace has poor ventilation and poor fire safety. Suppose also that you are subject to physical and verbal abuse at the hands of your employer and that there is a lack of drinking water in the workplace. Suppose further that you are paid only a couple of dollars per day and forced to work excessive overtime hours. Would these be satisfactory working conditions—for anyone, anywhere in the world? Conditions such as these are found in businesses commonly known as sweatshops.

Sweatshops exist throughout the world and in a variety of manufacturing industries, including apparel, shoes, toys, and electronics, among others. Sweatshops have become most notoriously famous within the footwear and apparel (or garment) industries. In these two industries, easy portability of work and technology from one region to another, or one country to another, has facilitated the ongoing presence of and reliance on sweatshop factories. For instance, from a historical perspective, apparel manufacturing has been a very mobile industry. It has migrated from Britain to New England in the United States, to the Southeastern U.S., to Mexico and Asia, with companies constantly pursuing less-expensive workers, a practice often referred to as “the race to the bottom.” In this race, clothing wholesalers and retailers have developed a manufacturing supply chain of a large number of contractors and an even larger number of subcontractors, all with the aim of securing the absolutely lowest cost anywhere in the world. Each move in the race to the bottom has been more fleeting than the preceding one, with an excruciating toll being exacted from the workers at the lowest rungs of the “economic food

chain” for the predatory benefit of others higher up and at the top.

Of course, this race to the bottom has not been confined to the footwear and apparel businesses. It is occurring in the production of computer motherboards, printers, laptops, and other electronics equipment. It can be found in any type of business that supplies products to large retailers—like Wal-Mart and Target—that operate on the basis of a low-price strategy. “These giants increasingly control the pricing power in overseas manufacturing that in turn dictates how much money factories can spend on improving labor conditions.” Moreover, “[a]nti-sweatshop efforts are fatally undermined by the schizophrenia of the transnational ‘brands’ themselves. The brands’ sourcing department pays ever-diminishing prices for the products (with ever-shortening delivery times) while the same brand’s CSR (corporate social responsibility) department requires compliance with the minimum wage and hours of work limits in the brand’s code and local laws, often combined with other CSR initiatives to be paid for entirely by the contractors. If the contractor doesn’t like this deal, then the brand will find someone else who will meet the order as offered.”

Unfortunately, most companies that are “benefiting from sweatshop labor around the world are doing nothing about it.” According to the Investor Responsibility Research Center, just 12% of S&P 500 companies have formal requirements that their suppliers address labor issues and only 4% have requirements that address all the issues—including the freedom to organize bans on child labor, forced labor, and discrimination—considered to be important by the International Labor Organization. “The latest corporate social responsibility (CSR) reports from companies like clothier Gap Inc. and toy-maker Mattel and multistakeholder

organizations like the Fair Labor Association and Workers Rights Consortium all document that sweatshop conditions in every country (including the U.S.) are alive and well."

Given that sweatshop conditions exist around the world, what can be done to counter these assaults upon human dignity and human rights that affect the most vulnerable people in the "economic food chain"? During the past several years a number of avenues of activism against sweatshops have emerged. For example, in the United States, student-led anti-sweatshop demonstrations and protests pressured some 200 colleges and universities into adopting "no-sweat" purchasing policies—especially for clothing emblazoned with the schools' logos. Ten universities in Canada also have "no-sweat" buying policies, as do several U.S. and Canadian cities. The Worker Rights Consortium (WRC) campaigns against sweatshops and helps to police factory compliance with "no-sweat" codes of business conduct. The WRC "does complaint-based and spot monitoring of plants that supply goods to its over 100 member universities." In 2003, the Fair Labor Association (FLA), whose members include companies such as Adidas-Salomon, Eddie Bauer, Inc., Levi Strauss & Co., Liz Claiborne Inc., Nike, Inc., the Phillips-Van Heusen Corporation, and Reebok International Ltd., as well as about 175 colleges and universities, began publicizing audits of factories regarding possible sweatshop conditions, including labor and human rights violations. These publicized audits put "pressure on Wal-Mart, Disney, Gap, and every other company that does labor monitoring, to release their audits, too." In May 2004, Gap Inc. issued its first social responsibility report in which it acknowledged that "many of the overseas workers making the retailer's clothes are mistreated and [the company] vowed to improve shoddy factory conditions by cracking down on unrepentant manufacturers." Gap uncovered "thousands of violations at 3,009 factories scattered across roughly

50 countries," including unacceptably low pay, psychological coercion and/or verbal abuse, lack of compliance with local laws, workweeks in excess of 60 hours, poor ventilation, and machinery lacking operational safety devices. Gap CEO Paul Presser says, "We feel strongly that commerce and social responsibility don't have to be at odds."

These are some of the more notable efforts that have been undertaken to combat sweatshop conditions around the world. They have met with varying degrees of success. Ultimately, however, true success only will be found in putting the brakes on the "race to the bottom," and in establishing an acceptable minimum level of conditions and compensation for workers on the lowest rungs of the "economic food chain"—acceptable minimums that will ensure them a living wage, protect their rights, and respect their dignity as human beings.

Currently, three major groups oversee factory inspections to monitor sweatshop conditions. These are Social Accountability International (SAI), with members including Toys "R" Us and Otto Versand, the German direct-mail giant; the Fair Labor Association (FLA), which was established by footwear and apparel makers such as Nike, Reebok International, and Liz Claiborne; and the Ethical Trading Initiative (ETI), a London-based organization composed of European unions, companies, and non-profits. All three groups have codes of conduct that specify standards and also oversee factory monitoring targeted toward enforcing their codes and remedying violations of the standards.

Due to considerable variation in the methodologies used by SAI, FLA, and ETI, many companies have engaged in some form of self-monitoring. For instance, "Wal-Mart says it inspects thousands of supplier factories each year in dozens of countries. But since no outside body such as SAI or the FLA is involved and Wal-Mart won't release its audits or even its factories' names, the public is left to take the company's word for it." However, the perceived confusion among the methodologies of

SAI, FLA, and ETI appears to be on the verge of changing as a consequence of an ambitious 30-month experiment, called the Initiative on Corporate Accountability & Workers' Rights that is being sponsored by six anti-sweatshop activist groups and eight global apparel makers. This initiative seeks "to devise a single set of labor standards with a common factory-inspection system that will 'replace today's overlapping hodge-podge of approaches with something that's easier and cheaper to use—and that might gain traction with more companies.' If it works, the 30-month experiment would create the first commonly accepted global labor standards—and a way to live up to them."

"This 30-month experiment is a great first step in bringing order to the piecemeal manner in which even the biggest companies set and monitor workplace conditions across the developing world. But a much broader solution is required to make real progress against sweatshop conditions. There are currently only about 100 large, mostly Western companies actively involved in the anti-sweatshop movement. Their efforts over the past decade are laudable but ultimately insufficient because thousands of other manufacturers don't participate. Building consensus around basic universal standards for particular industries, say apparel or consumer electronics, is crucial. Otherwise, why should one manufacturer incur the cost of upgrading and continually monitoring its workplace standards if it has to compete with factories without the same obligations?"

### Questions for Discussion

1. Why are sweatshops so common around the world?
2. Why are sweatshops viewed with disgust and abhorrence? Does a sweatshop accomplish anything positive?
3. What is a reasonable objective (or set of objectives) for addressing sweatshop conditions throughout the world? Explain your answer.
4. What is your assessment of the potential of the Initiative on Corporate Accountability & Work-

ers' Rights for making significant progress in alleviating sweatshops around the globe?

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This case was written by Michael K. McCuddy, the Louis S. and Mary L. Morgal Chair of Christian Business Ethics and Professor of Management, College of Business Administration, Valparaiso University. This case was developed from material contained in the following sources:

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